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CIS

1989 TAX RETURN FILING SEASON

HEARING

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

ONE HUNDRED FIRST CONGRESS

FIRST SESSION

MARCH 16, 1989

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1989 TAX RETURN FILING SEASON

THURSDAY, MARCH 16, 1989

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON OVERSIGHT,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:30 a.m., in room 1100, Longworth House Office Building, Hon. J.J. Pickle (chairman of the subcommittee) presiding.

[The press release announcing the hearing follows:]

FOR IMMEDIATE RELEASE
WEDNESDAY, FEBRUARY 8, 1989

PRESS RELEASE #3
SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
1105 LONGWORTH HOUSE OFFICE BLDG.
WASHINGTON, D.C. 20515
TELEPHONE: (202) 225-5522

THE HONORABLE J. J. PICKLE (D., TEXAS), CHAIRMAN, SUBCOMMITTEE ON OVERSIGHT, COMMITTEE ON WAYS AND MEANS, U.S. HOUSE OF REPRESENTATIVES, ANNOUNCES A HEARING ON THE 1989 TAX RETURN FILING SEASON

The Honorable J. J. Pickle (D., Texas), Chairman of the Subcommittee on Oversight, Committee on Ways and Means, U.S. House of Representatives, announced today that the Subcommittee will conduct a hearing on the Internal Revenue Service (IRS) and the 1989 tax return filing season. The hearing has been scheduled for Thursday, March 16, 1989, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 9:30 a.m.

Specifically, the Subcommittee will review: (1) the quality and availability of IRS taxpayer assistance, focusing on any recurrent taxpayer difficulties; (2) the preparedness of the IRS for the current filing season, including the availability of tax forms and publications, and the adequacy of staffing levels, employee training and IRS contingency plans; (3) the clarity of tax year 1988 IRS forms and instructions, focusing on areas that have proven to be particularly difficult for individual filers; (4) the use and planned expansion of electronic tax return filing; (5) the status of IRS Service Center workload inventories, including the volume of returns processed and refunds issued; and (6) the availability, utilization and capacity of IRS computer equipment, including the status of the Communications Replacement System and the Tax System Redesign plans.

The Subcommittee will receive testimony from representatives of the Internal Revenue Service, including the IRS Taxpayer Ombudsman and the Assistant Commissioners for Taxpayer Service and Returns Processing, Inspection, Computer Services, and Information Systems Development. Also, the General Accounting Office (GAO) will provide an interim report on IRS operations during the 1989 tax return filing season, including the preliminary results of GAO's survey to assess the accuracy of the telephone assistance provided to taxpayers by the IRS, and the status of the IRS's Tax System Redesign project.

In announcing the hearing, Chairman Pickle made the following statement, "Last year, the Subcommittee received testimony showing that Americans who called the IRS for help stood a 25 to 40 percent chance of getting an incorrect or incomplete answer. We also were told that taxpayers could not pick up necessary tax forms and publications from the IRS's walk-in offices because some IRS offices had not re-ordered forms and publications until the entire supply was depleted.

"As a result, the IRS Commissioner told this Subcommittee that the accuracy of telephone assistance ought to be improved, and that the reordering of tax forms only after the shelves are empty is inexcusable. For this reason alone, we expect improvements this year. Also, this is the second filing season affected by the tax law changes contained in the Tax Reform Act of 1986. Therefore, the IRS has had a year to provide additional employee training and to improve the level of expertise of telephone assistors.

"I remain hopeful that the IRS and the GAO will report to the Subcommittee that Americans are receiving the type of service they deserve during this filing season."

(OVER)

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Persons wishing to submit written comments for the printed record of the hearing should submit six (6) copies by the close of business, Friday, April 14, 1989, to Robert J. Leonard, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, room 1102 Longworth House Office Building, Washington, D. C. 20515.

SEE FORMATTING REQUIREMENTS BELOW:

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All statements and any accompanying exhibits for printing must be typed in single space on legal-size paper and may not exceed a total of 10 pages.
2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.
3. Statements must contain the name and capacity in which the witness will appear or, for written comments, the name and capacity of the person submitting the statement, as well as any clients or persons, or any organization for whom the witness appears or for whom the statement is submitted.
4. A supplemental sheet must accompany each statement listing the name, full address, a telephone number where the witness or the designated representative may be reached and a topical outline or summary of the comments and recommendations in the full statement. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press and public during the course of a public hearing, may be submitted in other forms.

Chairman PICKLE. We will ask the subcommittee to come to order. We would want to proceed, and we anticipate some other members will be here in just a minute. I think in interest of time, we will go ahead and proceed.

I would like to make a preliminary statement.

We meet today to hear from representatives of the Internal Revenue Service and the Government Accounting Office about the status of the 1989 tax return filing season.

I would like to welcome Mr. Murphy, who is appearing before us today for the first time as Acting Commissioner of the Internal Revenue Service. Mr. Murphy, we are glad that you are here.

Mr. MURPHY. Thank you.

Chairman PICKLE. Last year the filing season went relatively smoothly. I am hopeful that the same will prove true this year.

However, I am troubled by the reports of problems with telephone assistance accuracy and with the availability of forms and publications. These issues bothered me last year when we first identified them. What concerns me is not only that they continue to exist, but they appear to have worsened.

The filing season last year was the first time taxpayers prepared their returns under the new rules adopted as part of the Tax Reform Act of 1986.

So, it was not surprising that there would be confusion about the tax law. But now that we have had one filing season with the new tax reforms rules in place, I had hoped and expected to see a change in telephone assistance accuracy rates. Well, there was a change all right, but it was in the wrong direction.

Telephone assistance accuracy rates are lower than last year, and in some instances, they seem to have worsened since the beginning of the filing season.

At the call site serving my District in Austin, Texas, 67.5 percent of the inquiries were answered correctly during the first week of the IRS survey. By the second week, the figure had fallen to 59.8 percent, and during the third week of the survey, only 54 percent of the responses were given correctly.

Calling the IRS for tax advice sometimes can be a real crapshoot. Across the nation, when taxpayers call the IRS, one out of three times they are not going to get the correct responses to their questions. That is not good enough. Taxpayers deserve better and we have got to do better.

Last year, we heard stories about how taxpayers would walk into IRS offices and ask for the most basic forms, like the 1040. They were told that there were no forms available, because the office had waited until the supply was fully exhausted before reordering.

The Commissioner told us last year that that was inexcusable, and of course, it is. But now, GAO tells us that there are still problems with inventories of forms. So I ask the question, "What is the excuse then?"

This year does offer taxpayers a new opportunity—electronic filing of tax returns. Taxpayers in 36 States will be able to file their returns electronically, many for the first time. Next year, this service should be available to filers in all 50 States.

An electronic, paperless tax return system is the wave of the future. Electronic filing, we have heard, will save the IRS time and

money and allow for quicker refunds. It will cut down on error rates and make storage of tax returns much easier. So, we are interested to hear your thoughts on how electronic filing has worked, as well as your plans for expansion of this service.

We look forward to the testimony of the witnesses today representing both IRS and the GAO, and before we proceed, I will ask Mr. Schulze if he has any preliminary statements.

Mr. Schulze.

Mr. SCHULZE. Thank you, Mr. Chairman. I am pleased to join you in opening our hearing on the 1989 tax return filing season.

Last year there was considerable anxiety about how the IRS and taxpayers would cope with the first year of filing tax returns affected by the Tax Reform Act of 1986.

At the end of last year's filing season it appeared that both the IRS and taxpayers had managed the transition to a new system reasonably well. There were some weak points, but the belief was that they were temporary growing pains of adjusting to a new tax system.

Accordingly, we would expect the 1989 filing season to be better than the 1988 filing season, but unfortunately, the early results of the 1989 filing season are mixed.

Last week's announcement that the error rate for the IRS telephone advice to taxpayers was almost 31 percent is discouraging. This is worse than the 1988 accuracy rate.

At the comparable time of the 1988 filing season, the error rate was about 29 percent. So I am anxious to learn why the accuracy rate has fallen, and what the IRS is doing to improve it.

Mr. Chairman, last month the IRS testified before us on its suggestions to reform the tax penalty structure. It has recommended steps to increase the accuracy level imposed on taxpayers in order to avoid penalties. It is somewhat inconsistent for the IRS to propose raising the accuracy level imposed on taxpayers when its own accuracy rate is falling.

Other aspects of the 1989 tax filing season appear to be more in line with expectations, but our witnesses can give us more details.

We want to know how smoothly tax returns are being processed, how big is the average refund, how long does the taxpayer wait for his refund check, and how does the number of returns filed so far this year compare with the filing pace of last year.

Mr. Chairman, the tax filing season is the one time each year that most taxpayers have direct contact with the IRS. We want that contact to be smooth and efficient for the sake of both the IRS and the taxpayer.

The IRS now refers to taxpayers as its customers, but the problem is that we as customers cannot take our business to a different store if we do not like their service. Therefore, we must work with the IRS to provide quality service to the taxpayer.

Now, as that statement is somewhat critical, we also have to keep in perspective that the IRS budget request last year was not only cut by $100 million, but they had to absorb an additional $259 million because of increased expenses. So that is a reduction of $359 million from what they anticipated or said they needed.

We also have to keep in perspective that according to my information it costs us about one percent to collect the money that the

IRS collects. Perhaps we should take another look at the resources that we give to the IRS, and make sure that if additional funds will lead to increased accuracy, that we head in that direction.

One other point related to accuracy, is do we know how many times that advice was incorrect in favor of the IRS, and how many times that information was incorrect in favor of the taxpayer. It may be that it works out even, but that does not forgive the fact that there are error made. We want to do everything we can to solve those, because it does lead to a deterioration in the respect and the support of the general public for the IRS.

I thank you, Mr. Chairman.

Chairman PICKLE. Mr. Murphy, if you will proceed now, we will be glad to receive your testimony. If you would, please identify the two gentlemen at the table with you?

STATEMENT OF HON. MICHAEL J. MURPHY, ACTING COMMISSIONER OF INTERNAL REVENUE, ACCOMPANIED BY JOHN L. WEDICK, JR., DEPUTY COMMISSIONER FOR PLANNING AND RESOURCES, AND CHARLES H. BRENNAN, DEPUTY COMMISSIONER FOR OPERATIONS

Mr. MURPHY. Thank you, Mr. Chairman, and good morning to you and others on the committee.

I am pleased to be here to report on the preparations for and the progress of the 1989 filing season. I will also discuss our progress in modernizing our tax information systems.

With me today, on my left and on your right, is Charly Brennan, the Deputy Commissioner for Operations. On my right and on your left is John Wedick, the Deputy Commissioner for Planning and Resources.

Chairman PICKLE. Mr. Murphy, before you continue on, I understand that Mr. Brennan's mother's birthday is tomorrow, and in the spirit of St. Patrick's Day, we wish her well and you too.

Mr. BRENNAN. My mother appreciates that sir. Thank you. [Laughter.]

Mr. MURPHY. Thank you, Mr. Chairman.

My mother Dottie Maloney appreciates that too——[Laughter.]

Mr. MURPHY [continuing]. And we wish you all a Happy St. Patrick's Day.

Also with me, Mr. Chairman, are the various assistant commissioners whose responsibilities cover several of the topics that we will discuss today, and we also have our Taxpayer Ombudsman with us.

Let me begin by saying that the IRS has been and will continue to be committed to providing quality service to the American public.

We share the subcommittee's desire to see that the tax laws are carried out in a manner that is fair to taxpayers and that encourages voluntary compliance. We welcome the subcommittee's interest in our operations and assure you of our cooperation in working with the subcommittee.

For your convenience, Mr. Chairman, I would like to highlight our written statement and will of advise you where I am as I go along.

Chairman PICKLE. That would be agreeable, and your entire statement will be in the record, but kind of point out to us as you go along.

Mr. MURPHY. Thank you, Mr. Chairman.

Let me start off talking about the 1989 filing season, which is, on page 2 of my statement.

Our general assessment, Mr. Chairman, is that the filing season is progressing smoothly, without any major disruptions. Thus far, taxpayers are filing returns earlier, and we are seeing a shift to the more simple forms 1040A and 1040EZ, which is certainly a bright light.

Returns are being processed in a timely manner, refunds are being issue within normal time frames, forms are generally available, service center inventories are manageable, and access to the IRS taxpayer assistance is not a major difficulty.

Forty percent of our 109 million projected returns have been received, Mr. Chairman. As far as the processing of returns, and I am still on page 2, this year we expect to receive, as I said, over 109 million individual tax returns. In anticipation of this workload, we expect to have 40,000 employees processing returns during the peak filing season compared to 38,000 last year.

If you will turn to page 21 of my testimony, you will see the most recent filing season statistics that we have for returns and refunds.

As you can see, the returns filed this year are ahead of last year by about 2.2 percent. The number of returns processed this year are also ahead by 2.2 percent.

The average refund, in answer to Mr. Schulze's question, is $827, which is $25 more than last year.

Our computer operations, Mr. Chairman, both hardware and software, have gone well.

Let me talk a little bit about electronic filing, which of course, you covered in your opening statement. One of the most positive indicators we have is the growth in the number of returns that have been filed electronically. Electronic filing was started only in 1987 and has mushroomed already into a very successful program.

As you can see on page 23 of my testimony, 862,000 returns have been filed thus far this year, compared to 583,000 for all of last year.

Turning to page 5 of the testimony, electronic filing is now available in 48 districts this year, and all participating districts have the additional capability of depositing refunds into the taxpayers' bank accounts through electronic funds transfer.

This program is particularly successful in that the error rate is so much lower than for paper returns. The error rate for paper returns is approximately 20 percent, which includes IRS and taxpayer errors. This 20 percent compares quite favorably to a less than 3-percent error rate for returns filed electronically. Electronic filing will be available in all districts next year.

We, of course, recognize the need to manage this program carefully and are receptive to any suggestions that you may have to make this activity available to more and more taxpayers.

Let me go to pages 6 through 9, Mr. Chairman, and talk a little bit about forms and publications.

Taxpayers can obtain tax forms and publications from the IRS either by calling us toll-free, writing to one of our centralized forms distribution centers, or by going into one of our local offices personally. So they can phone us, or they can write to us, or visit the sites.

Data on orders from our centralized distribution centers indicate that it takes approximately 7 to 8 days for a taxpayer to receive an order for a form from the time the taxpayer sends in the order.

We continue to emphasize the importance of providing forms and publications to taxpayers when they visit an IRS office. This year, we provided our regions with a list of the 79 most requested forms and publications. Based on local conditions, such as the available office space and the expected demand for those types of forms, local offices then decide on the forms and publications that they would actually stock.

If local offices did not stock all 79 of these publications or the forms, or the supply was temporarily out of stock, taxpayers could obtain a special order form which the local office would express mail to one of our centralized distribution centers. The taxpayer would then receive the tax material in less than 10 days.

Some of these corrections, Mr. Chairman, were made as a result of some of the discussions we had in your hearing last year.

We have monitored the filling of orders at the centralized centers. Overall, we believe that we are doing a good job in filling orders, while noting some exceptions among the less frequently requested forms.

For example, thus far we sampled 32,000 orders before they were sent out to the taxpayers, and found that 96 percent of those orders had been correctly processed.

As you will find out in other comments I make, Mr. Chairman, we feel that quality is the key, but we also recognize that followup to correct poor quality is necessary too.

Let me share with you a little bit about what we are doing in, not only trying to get the forms out, but in the testing area.

We are getting taxpayers to give us their ideas on forms improvements. Mr. Chairman, we began focus group testing in 1987 where we actually meet with the people that are trying to fill out our forms.

This year, we also scheduled town meetings, where we actually go out and listen to the taxpayers and try to get their ideas on what we can do to make their job of trying to comply a lot more easier, and certainly, a lot effective.

Let me now move to page 10 of my testimony, Mr. Chairman, and talk a little bit about taxpayer service.

We have a taken a number of measures to improve the access to taxpayer service, as well as the quality of service taxpayers receive once they get through to us.

We increased the number of toll-free lines by 6 percent. We increased the number of Tele-Tax lines, which of course, are the recorded messages that taxpayer can get upon calling us. We have increased those by 10 percent, Mr. Chairman. We increased the number of toll-free assistors by 15 percent. I believe we have somewhere around 5,000 assistors.

We continue to improve the training programs for our toll-free assistors and for our front-line managers. We use simulation techniques, probing techniques and last but not least, management review and quality review techniques.

We have established regional diagnostic centers in each region to assist local toll-free call sites in identifying problem areas that the local office is not handling well, which helps to remedy any problems that are identified. We believe that these centers will aid considerably in improving our accuracy rates.

We recognize that measuring quality is important, but immediately after recognizing what that quality is, we have got to make followups on a timely basis, so that we can ensure that taxpayers are not filing an incorrect return.

We do not want to give taxpayers wrong answers, Mr. Chairman. We expect to respond to as many as 38 million calls this year, 20 million of those calls handled during the filing season. We still have on target our objective of an 85 percent level of service.

Let me move to the toll-free accuracy, Mr. Chairman, which is in pages 12 to 14 of my testimony.

Last year, we worked with GAO to institute our Integrated Test Call Survey System. Specially trained personnel from the National Office in Washington place calls to our toll-free sites around the country to assess the courtesy, the completeness, and the accuracy of the responses to taxpayer inquiries.

The system allows us to identify those areas of tax law that need to be emphasized in training, as well as those offices that need particular assistance. It also provides information on trends that are taking place in our technical responses.

Last year, approximately 20,000 of these calls were placed during the filing season. We expect to make about 15,000 calls this year. We have expanded the number of questions we are asking to 62 questions, which will cover 32 tax law categories. We reviewed our questions, the answers and the scoring methodology with GAO.

As of March 10, Mr. Chairman, the test call system tells us that assistors provided incorrect answers 29 percent of the time, which could result in the taxpayer making an error on their return. The system also shows assistors are meeting the standard that IRS and GAO agreed upon 62.4 percent of the time.

And Mr. Chairman, whether the number is 71 percent, or whether it is 62 percent, our current accuracy rate is unacceptable. I am aware of what you said last year on April 13, and I am also aware that when you said that anything under 75 percent is unacceptable, Larry Gibbs, our former Commissioner, agreed with you. So we are not satisfied with this accuracy rate.

However, while these results are disappointing, we believe that we are going in the right direction with our taxpayer service function. We believe that the answer lies in further improving our training, working to build a stable and experienced work force, and adding new technology such as our Automated Taxpayer Service System, which is being piloted in Dallas, Tex.

We also expect that our regional diagnostic centers, which are in place for the first time this year, will play a significant role in improving our accuracy rates. We began this whole system in 1988, and we plan on staying on course with that. We also certainly plan,

INTENTIONAL BLANK

Mr. Chairman, on staying on course with our relationship with GAO to perfect this system as we continue to work on this.

The tax law is complex. There have been 138 separate public laws which amend the Internal Revenue Code since 1975. We know our taxpayer assistors have a difficult job, and I think they do that difficult job well. Given the complexity of the law and the difficulties in recruiting and retaining a work force in a competitive labor market, you can see the magnitude of the challenge of providing taxpayer service.

Mr. Chairman, there have been seven changes to the tax law since the Tax Reform Act of 1986 was passed, and I might add that several of those new laws are unfunded. That is just a commercial, Mr. Chairman, that I would put in here.

Although we are offering a lot of reasons, I want to assure you, Mr. Chairman and others on the subcommittee, I am not giving these to you as excuses. I believe in what we are doing, and I believe that the efforts will result in improved accuracy of our answers.

Once achieved, the challenge will be in retaining, a work force that is trained properly from one filing season to another. The bottom line, however, is that the tested accuracy rates we have today are not acceptable.

Let me assure the subcommittee that we will not be satisfied until we see substantial improvements. We need your help, Mr. Chairman, in limiting law changes. Now, I know you understand I am not saying, "No changes," but I think that we all have to be aware of the impact that complexity and change has on 109 million taxpayers, our customers and your constituents.

I would never dispute the fact that there should be agreed upon measurements, for all of our functions covered in the IRS-GAO Study that we testified on recently. We agreed to establish such systems and we are dealing with that. This, of course, includes taxpayer service.

In conclusion Mr. Chairman, we see a filing season that is very similar to last year's, which GAO characterized as successful. We have contingency plans in place. While not satisfied with our toll-free accuracy rates, nor the accuracy and clarity of our correspondence, there are many positive indicators. Other sources, such as the Ombudsman and Internal Audit, have not identified significant problems.

Mr. Chairman, with your permission, I would like to give you some information on the tax system modernization before I conclude.

So at this point, I would switch from a discussion of the current filing season to address the future. Specifically, I want to discuss our plans for modernizing tax information systems in the 1990's.

Very briefly, the problem, as we discussed with you in previous years, is the IRS is faced with a challenge of processing hundreds of millions of documents a year and collecting in excess of $1 trillion using processing systems that were designed in the 1950's.

One of the most important functions in the running of the Government is the collection of revenue. To have it accomplished with antiquated information systems is very dangerous.

So faced with a growing workload and ever-changing tax laws, future demands cannot be met without sustained investment in new information systems. The shortcomings of the information systems are very clear. They are truly antiquated, especially when you have a system that depends on magnetic tape for the storage of information. They are paper intensive, and they are labor intensive.

What is the solution, Mr. Chairman? I believe it is essential that IRS modernize our outdated and inefficient computerized tax processing system. Our approach has been to design a master plan for modernizing the tax system, which would meet all the needs of the IRS in the 1990's and beyond.

Thus, we are not only planning for the acquisition of new computer equipment, but we are also redesigning our information systems so that we can be as responsive to our customers—the American taxpayers—as the leading private sector financial institutions are in dealing with their customers.

I know that is something that this subcommittee has been expecting and supporting. We have completed a comprehensive management plan that outlines the vision that we have of our system, and the way it should look in the 1990's.

Various individual projects are now under way. One of the key features of our modernization effort is that various projects will be phased in over the next 10 years. Rather than try to implement a new system all at once, we have chosen this approach to minimize the impact that new systems will have on our existing systems.

You have already seen the fruit of some of our efforts—electronic filing is one project that has become operational.

Our testimony on pages 17 through 19, Mr. Chairman, covers three of those projects. The document processing system, which uses optical imaging technology. The automated underreporter system, which uses an on-line computer system to replace the current system of manually reviewing discrepancies. The third is the on-line entity project, which would put certain identifying data from the tax return, such as the taxpayer's name, Social Security number and address on an on-line computer system.

These projects are well underway, and the prototypes for the projects are planned in the near future.

I would also point out that fiscal year 1990, Mr. Chairman, is a key year for our tax system modernization effort. Design and procurement projects for future systems depend on fiscal 1990 funding. Several of the key elements of the tax system modernization effort are at the solicitation stage and are planned around fiscal 1990 funding.

The administration has recognized the importance of our modernization efforts and has made this an administration budget priority.

We need the subcommittee's support as well if we are to achieve our goal of administering the tax laws in the 1990's with 1990 technology.

Mr. Chairman, I have covered an awful lot of ground here today. Mr. Wedick, Mr. Brennan and I would be happy to answer any questions that you or other members of the subcommittee would have.

Thank you, Mr. Chairman.
[The statement of Michael J. Murphy follows:]

TESTIMONY OF
MICHAEL J. MURPHY
ACTING COMMISSIONER OF INTERNAL REVENUE
BEFORE THE
SUBCOMMITTEE ON OVERSIGHT OF THE
HOUSE WAYS AND MEANS COMMITTEE
MARCH 16, 1989

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to report to you on our preparations for and the progress of the 1989 filing season. Also, I will discuss our progress in modernizing our tax information systems. With me today are Deputy Commissioners John Wedick and Charly Brennan. Also joining us are the Taxpayer Ombudsman and the Assistant Commissioners for Taxpayer Service and Returns Processing, Computer Services, Human Resources and Information Systems Development.

Let me begin by saying that the IRS has been and will continue to be committed to providing quality service to the American public. We share this Subcommittee's desire to see the tax laws carried out in a manner that is fair to taxpayers and that encourages voluntary compliance. We welcome the Subcommittee's interest in our operations and assure you of our cooperation in working with the Subcommittee.

I. THE 1989 FILING SEASON

A. General Assessment

Overall, the filing season is progressing smoothly, without any major disruptions. Thus far, taxpayers are filing returns earlier and we are seeing a shift to the more simple forms 1040A and 1040EZ. Returns are being processed in a timely manner, refunds are being issued within normal time-frames, forms are generally available, service center workload inventories are manageable and access to IRS taxpayer assistance is not a problem. Although we are still working to improve the accuracy of our responses to taxpayer inquiries on our toll-free telephone lines, we believe that, overall, the filing season is going smoothly.

B. Processing Tax Returns

1. Service Center Readiness--This year, we expect that our 10 service centers will receive over 109 million individual income tax returns. (See Appendix A for current filing season statistics on returns and refunds.) In anticipation of this workload, we expect to have 40,000 employees processing returns during the filing season peak compared to 38,000 last year.

As we did last year, we established an Executive Steering Committee at the National Office chaired by the Assistant Commissioner (Taxpayer Service and Returns Processing). The Committee identified potential problem areas and provided guidance for resolving those problems. In addition, a subcommittee, the Filing Season Readiness Group, was formed to ensure that IRS service centers were ready for the filing season.

Service center instruction manuals were revised and made available well in advance of the filing season. Service centers were visited and procedures were reviewed. Results of these readiness reviews were reported to top management.

2. Computer Operations--Our computer hardware and software preparations have gone well. Our tax processing computer programs have been revised, reviewed and tested well in advance of their need. In addition, hardware readiness reviews were conducted at each service center, the Martinsburg Computing Center and the Detroit Computing Center. No major problems were identified and the computer room operations are in good shape for the filing season.

On December 31, 1988, the final site for the Communication Replacement System became operational. Thus, all service centers now have new systems and they are operating without any problems.

With respect to computer capacity, we have taken a number of concrete actions to ensure that capacity in existing systems is sufficient until our Tax System Modernization project is implemented.

First, we have completed the first of two phases in our Service Center Workload Redistribution project. The goal of this project is to spread the tax processing workload more evenly among the service centers. The first phase was completed in January 1989 and is running smoothly. A second measure to address capacity is the installation of dual 1100/84 computers in each of the service centers to provide flexibility for future workload redistribution. These computers have already been installed in the six larger service centers and will be installed in the remaining four centers this fiscal year.

We will continue to identify additional measures we can take to ensure that there is no so-called "capacity gap". We are confident that the measures we are reviewing will be sufficient to handle currently projected increases in our computer capacity needs. However, the ultimate solution to meeting capacity needs continues to be our Tax System Modernization project which I will discuss later in my statement.

3. Service Center Inventories--We continue to make excellent progress in reducing the workload inventories at our service centers. All centers going into the filing season had manageable inventories. Our adjustments inventory declined from 371,000 cases in January 1988 to 341,000 in January 1989. Our unpostable inventory also dropped from 432,000 in January 1988 to 222,000 in January 1989.

4. Electronic Filing--Our electronic filing program continues to be a success. We expect the number of electronically filed tax returns to reach 2 million returns this year. As of March 9 of this year, almost 900,000 returns had been filed electronically compared to just under 600,000 electronically filed returns for the entire year last year.

We have expanded the number of districts that are covered under this program from 16 to 48. All participating districts also have the capability of electronic funds transfer to permit refunds to be deposited directly into taxpayers' personal savings or checking accounts.

We continue to see a dramatic difference in the error rate between returns that are filed electronically and those that are filed on paper. The error rate for paper returns (including errors made by IRS and by taxpayers) is approximately 20 percent. In comparison, the error rate for electronically filed returns is less than 3 percent.

We are experiencing no significant problems with this program. As a result, we expect that the program will be available in all districts beginning next year.

5. Contingency Plans--We have reviewed our service center contingency plans and continue to emphasize the early monitoring of tax return receipt patterns to identify any unexpected trends in order to determine if workloads should be transferred between service centers. In addition, the Martinsburg Computer Center can provide computer support if a service center's processing workload exceeds available resources.

C. Distributing Forms and Publications

1. Forms Testing

We are continually seeking new and effective ways to gain a better understanding of what taxpayers think of our forms and what problems they have with them. We are currently conducting a series of town meetings around the country this year to get public comments on our forms and instructions.

Also, beginning in 1987 and continuing this past year, we have conducted focus group testing which has enabled us to make several important changes to our forms before they were mailed to taxpayers. We have found that focus group testing improves our forms so that taxpayers understand our forms better, taxpayer errors are reduced, and the pipeline processing of returns proceeds more smoothly with this type of testing.

2. Forms Distribution Readiness

Taxpayers can obtain tax forms and publications from the IRS either by calling toll-free or writing one of our centralized forms distribution centers or by going to one of our local offices personally.

Our third and final centralized forms distribution center is now fully operational in Sacramento, California. The other two centers are located in Richmond, Virginia and in Bloomington, Illinois. Thus, the entire country is now serviced by these regional distribution centers.

We continue to emphasize the importance of having forms and publications available when taxpayers come in to an IRS office. This year, we provided our regions with a list of the 79 most requested forms and publications. Local offices then decided on the forms and publications they actually would stock based on local conditions such as the available office space and the expected demand for forms.

In instances where a taxpayer cannot obtain a particular form at one of our offices, we provide a special order form. Once that order form is prepared by the taxpayer, we express ship it to one of our three distribution centers. The taxpayer normally will receive the tax material they ordered in less than 10 days.

There are also two regular weekly conference calls to IRS field officials that address forms distribution. In addition, during the peak period earlier in the filing season, calls to managers in the centralized distribution centers were made daily. They are now made weekly.

We also added night shifts at the centralized distribution centers to ensure that we were able to turn orders around within 48 hours.

Let me point out two other areas where we are working to improve the availability of forms and publications. First, as part of our program to make forms available to tax practitioners, we created several pre-assembled tax form packages for practitioners. We arranged to have these packages mailed directly to practitioners from the printing contractors which avoided having distribution centers handle thousands of tax forms. As a result, practitioners got their forms and selected publications earlier and it cost less.

As you know, we have worked with banks, post offices, and libraries for many years to stock certain forms. This year we increased our number of accounts for post offices by 10 percent and banks by 5 percent. In addition, the IRS and the Public Library Association have formed an Advisory Committee to find better ways of distributing forms and to improve communications between libraries and IRS.

3. Forms Distribution

To ensure that we maintain responsive, high quality service, we conduct a number of evaluation programs including sampling orders just before they are mailed to taxpayers. This test is statistically designed to reflect the exact make-up of all orders processed in our distribution centers. Our tests tell us we are doing a good job in filling taxpayer orders, while noting some exceptions among the less frequently requested forms. Our sample of 32,000 orders tells us that approximately 96 percent of all orders have been correctly processed.

In addition, we have not experienced any significant delays in filling orders for forms. The order rate is now declining as we have passed the peak period for requests for forms and publications.

4. Contingency Plans

There are two major facets to our contingency plans for forms distribution. First, the toll-free telephone system we have for ordering forms is able to transfer taxpayer calls to the distribution center best able to handle traffic. Thus, if one center experiences an overload of calls, the phone system is able to switch incoming calls to another center.

Second, in the case of severe disruption of forms distribution, we have designated our Florence, Kentucky forms center as a back-up distribution site. This center is equipped to handle toll-free calls for the current filing season.

D. Providing Taxpayer Assistance

As you know, providing quality service has been a priority with the IRS, especially over the past several years. During that time, the resources for providing assistance to taxpayers have increased. We have increased the number of toll free telephone lines, the number of toll-free assistors and the number of Tele-Tax lines. We have also re-emphasized our commitment to providing improved quality service. We understand that without adequate training and a commitment to

quality, we can't improve. We are involved in an effort to upgrade the toll-free and Tele-Tax service we provide taxpayers and believe that we have the process in place to accomplish that goal. Our preparations for this filing season reflect that effort to provide timely and quality assistance.

1. Taxpayer Service Readiness

A. Accessibility--As we did last year, we made it easier for taxpayers to contact the IRS for assistance. The number of lines for toll-free tax assistance was increased by 6 percent over 1988. Tele-Tax lines were increased by 10 percent over 1988. Some telephone traffic was permanently re-routed in certain geographic areas to provide for improved accessibility. The number of toll-free assistors increased again this year, up 15 percent to a total of 5,051 assistors.

In FY 1988, we answered 38.5 million toll-free calls. This year, we expect to answer 37.9 million calls. This drop is largely because we expect taxpayers to become more familiar with the new tax law this year and because more and more taxpayers are using the Tele-Tax system to access pre-recorded tax information.

Given the demand we expect and the staffing we are making available, through reprogramming from other areas, we intend to provide an 85 percent level of service. Thus far this year, we are right on target.

As we did last year, we continue to provide extended hours of service and are providing toll-free service on Saturdays.

B. Training--We are continuing to improve the training programs for our toll-free assistors to increase their effectiveness. The classes now include a series of simulated telephone exercises to allow trainees the opportunity to try out their skills and knowledge prior to contact with taxpayers. Training courses have been re-written and include a focus on probing techniques so that assistors can determine what additional information is needed to answer questions correctly and completely.

Entry level management training is being revised as well with an emphasis on management review and quality. An audiotape of simulated phone conversations is being developed to give new managers practice monitoring and evaluating telephone calls.

C. Automated Taxpayer Service System--As we reported to you last year, we are working to bring automated tools to the Taxpayer Service area. A prototype of a new system is being tested in our Dallas toll-free site that has the potential to increase accuracy and productivity. This system provides 1) automated reference material such as the Internal Revenue Code, IRS publications and revenue rulings, 2) the capability of ordering forms for taxpayers electronically, saving several days over the current method of mailing a request to the centralized distribution center from the toll-free site, and 3) additional account related information to deal with those types of inquiries. If the concept proves successful, we will expand the test in calendar year 1990.

D. Toll-Free Monitoring--As you know, we were not satisfied with the accuracy rates for toll-free assistance last year. One of our new initiatives this year is the establishment of diagnostic centers in each of the seven regions. These centers analyze data produced by the National Office's test call survey and provide information to the assistors in their particular region on tax law categories that they are not handling well. They also make their own diagnostic test calls to pinpoint problem areas, and work with local Taxpayer Service Offices to remedy and problems identified. The actions a local office may take include preparing job aids for assistors or suggesting technical tax law topics which need to be addressed during local office training sessions during the filing season. The diagnostic centers give us the ability to provide prompt targeted action in district offices that are having problems with accuracy in particular areas.

2. Toll-Free Accuracy

Last year, we worked with GAO to institute our Integrated Test Call Survey System. Specially trained personnel from the National Office in Washington place calls to our toll-free answering sites around the country to assess the courtesy, completeness and accuracy of the responses to taxpayer inquiries. The system allows us to identify those areas of tax law that need to be emphasized in training, as well as those offices that need particular assistance. It also provides information on trends in our technical responses.

Last year, approximately 20,000 calls were placed during the filing season. We expect to make approximately 15,000 calls this year. We have expanded the number of questions we are asking to 62 questions which will cover 32 tax law categories. We reviewed our questions, answers and scoring methodology with GAO.

As of March 10th, the test call system indicates that assistors provide correct answers to 62.4 percent of the test questions. The system also tells us that an additional 8.6 percent of assistors' answers were right in that taxpayers would still file an accurate return even though these answers did not meet the standard agreed to by IRS and GAO. Thus, the system shows that 29 percent of the answers by assistors were clearly wrong.

We are not satisfied with this accuracy rate. While these results are disappointing, we believe we are going in the right direction with our Taxpayer Service function. We believe that the answer lies in further improving our training, working to build a stable and experienced workforce, and adding new technology when appropriate. We began to do that in 1988 and we will continue on that course. We also expect that our regional diagnostic centers, which are in place for the first time this year, will play a significant role in improving our accuracy rates.

The tax law is complex; there have been 138 separate public laws which amend the Internal Revenue Code since 1975. We know our taxpayer assistors have a very difficult job. Given the complexity of the law and the difficulties in recruiting and retaining a workforce in a competitive labor market, you can see the magnitude of the challenge of providing taxpayer service. But we are not offering excuses and we are not backing away from the challenge. I believe we are doing everything we can and I believe these efforts will result in improved accuracy of our answers. Once achieved, the challenge will be in retaining a trained workforce from one filing season to the next.

I should also point out, however, that any test call system that uses preprogrammed questions has its limitations. Analysis has shown that the question and response dynamic between a taxpayer and an assistor is extremely complex. Even seemingly straightforward taxpayer inquiries are actually very involved. Taxpayers bring a unique set of facts with their question and an assistor must address the taxpayer's specific situation. The test call system demands that an assistor bear the primary responsibility for probing for all facts necessary to give an accurate and complete answer. However, in real life, the responsibility often is shared between the taxpayer and the assistor. Frequently, taxpayers will not let an assistor give an answer without providing additional facts. Thus, the test calls we place to assistors can be characterized as harder than the real life questions the assistor will face. However, because no test call system can duplicate real life questions, we have chosen to employ a test call system that may be more difficult for assistors to respond to and thus may produce lower accuracy rates than the true accuracy of our answers when dealing with the public.

The bottom line, however, is that the tested accuracy rates we have today are not acceptable. Let me assure the Subcommittee that we will not be satisfied until we see substantial improvements.

E. CONCLUSION

Overall, Mr. Chairman, we see a filing season that is very similar to last year's, which GAO characterized as successful. While not satisfied with our toll-free accuracy rates thus far, there are many other positive indicators. We have no indications of any significant problems from any of our monitoring offices. The National Office Command Center, a 24 hour a day office that monitors the status of our computer operations, reports a reduction in problems over the last year. We continue to monitor the status of operations with our conference calls between National Office and field management.

III. TAX SYSTEM MODERNIZATION

At this point, I would like to switch from a discussion about the current filing season to address the future. Specifically, I would like to discuss our plans for modernizing our tax information systems in the 1990's.

1. The Problem

As we have discussed with you in previous years, the IRS is faced with the challenge of processing hundreds of millions of documents a year and collecting in excess of one trillion dollars using processing systems that were designed in the 1950's. One of the most important functions to the running of the government--the collection of revenue--is being accomplished with antiquated information systems. Faced with a growing workload and ever changing tax laws, future demands cannot be met without sustained investment in new information systems.

The shortcomings of existing information systems are:

A. They are truly antiquated. For example, IRS' main computer systems still depend on magnetic tape for storage of information, limiting immediate access to account information.

B. They are paper intensive. For example, it normally takes a minimum of two and often up to six weeks for an employee to obtain a copy of an original tax return.

C. They are labor intensive. Tax returns must go through a lengthy processing system before the data is updated to our computer files. This processing is not only costly but error prone.

2. The Solution

It is essential that IRS modernize our outdated and inefficient computerized tax processing systems. We have begun to do so and are well on our way. Our approach has been to design a master plan for modernizing the tax system to support for all the needs of the IRS in the 1990's and beyond. Thus, we are not only planning for the acquisition of new computer equipment but are also redesigning our information systems so that we can be as responsive to our customers--the American taxpayers--as the leading private sector financial institutions are to their customers.

We have completed a comprehensive management plan that outlines the vision of what we would like our system to look like in the 1990's. The plan, which has been reviewed and endorsed by both Treasury and OMB, details the responsibility and authority of IRS personnel for this project; it outlines procurement strategy, telecommunications strategy, and transition plans for various components of the new system.

Various individual projects are now underway. One of the key features of our modernization efforts is that various projects will be phased in over the next ten years. Rather than try to implement a new system all at once, we have chosen this approach to minimize the impact that new systems will have on existing systems. You have already seen the fruit of some of our efforts. Electronic filing is one project that has become operational.

Let me give you several examples of some of the other projects that are underway:

A. The Document Processing System--Rather than process and store paper tax returns, IRS would use optical imaging technology. When filed, a paper return would be "imaged" before processing. The imaged return would be processed and converted to machine readable form for use in automated processing. In addition, IRS employees would work from the imaged return rather than the paper return for other operations such as examinations and collection of taxes. Storing and retrieving images rather than paper will be more efficient and cost effective.

B. Automated Underreporter--The Underreporter Program was established to identify discrepancies between items of income reported on income tax returns submitted by taxpayers and the corresponding information returns submitted by employers, banks, and other payors. Using an on-line computer system, the Automated Underreporter System will replace the current system of manually reviewing discrepancies. This will reduce paperwork by automating tax account research and the generation of notices related to discrepancies.

C. The On-Line Entity Project--This will put certain identifying data from the tax return such as the taxpayer's name, Social Security Number, and address on an on-line computer system. Currently, this data must be researched through our tape driven systems. By placing it on-line, service centers will be able to immediately correct inaccurate identifying data thus greatly reducing the number of unpostable cases. In addition to more timely and accurate posting of taxpayer account information, the lower unpostable inventories will be easier to manage, and will require less physical space and computer capacity.

These projects are well underway and prototypes for the projects are planned in the near future.

I would also point out that FY 1990 is a key year for our Tax System Modernization effort. Design and procurement projects for future systems depend on FY 1990 funding. Several of the key elements of the Tax System Modernization effort such as the Service Center Support System, which will provide some capacity relief for our existing 1100/84 systems, are at the solicitation stage and are planned around FY 1990 funding.

In closing, let me emphasize that our modernization efforts are more than simply replacing outdated and inefficient computerized systems. As we develop new systems configurations and replace overburdened equipment, we are also searching for and identifying ways to use information technology to provide more timely and better quality service to taxpayers. The IRS is committed to providing an improved level of service through a coordinated systems planning and development process that embraces information technology.

The Administration has recognized the priority of our modernization efforts and has made this an Administration budget priority. We need the Subcommittee's support as well if we are to achieve our goal of administering the tax laws in the 1990's with 1990's technology.

IV. CONCLUSION

Mr. Chairman, I have covered a lot of ground today. Mr. Brennan, Mr. Wedick, and I would be happy to answer any questions the Subcommittee might have.

APPENDIX A

INDIVIDUAL INCOME TAX RETURNS
RECEIVED AND PROCESSED

Returns received and processed in service centers through March 11, 1988 and March 10, 1989. (In thousands)

1. Weekly		1988	1989	Percent Change
a) Receipts:	1040	3,707	3,903	5.3
	1040A	963	1,011	5.0
	1040EZ	967	1,112	15.0
	Total	5,637	6,026	6.9
b) Processed:	1040	3,411	3,356	-1.6
	1040A	1,580	1,794	13.5
	1040EZ	1,606	2,108	31.3
	Total	6,597	7,258	10.0

2. Cumulative From January		1988	1989	Percent Change
a) Receipts:	1040	21,679	21,138	-2.5
	1040A	9,985	10,733	7.5
	1040EZ	10,707	11,422	6.7
	Total	42,371	43,293	2.2
b) Processed:	1040	12,283	12,434	1.2
	1040A	7,601	7,693	1.2
	1040EZ	8,803	9,188	4.4
	Total	28,687	29,315	2.2

REFUND COMPARISON CHART

Refunds certified by National Computer Center through March 11, 1988 and March 10, 1989. (In thousands)

	1988	1989	Percent Change
1. Weekly			
a) Number (Thousands)	6,390	6,135	-4.0
b) Average Refund	801.46	803.37	1.5
2. Cumulative from January			
a) Number (Thousands)	19,050	18,435	-3.2
b) Average Refund	801.79	826.66	3.1

INDIVIDUAL INCOME TAX RETURNS
ELECTRONICALLY FILED
MARCH 9, 1989

Weekly	Cincinnati	Ogden	Total
Receipts			
Accepted	51,160	33,789	84,949
Error Resolution	2,375	1,720	4,095
Accuracy Rate	95.4%	94.9%	95.2%
Unpostables	2,126	1,239	3,365
Cumulative			
Receipts			
Accepted	585,996	275,920	861,916
Error Resolution	16,234	8,956	25,190
Accuracy Rate	97.2%	96.8%	97.1%
Unpostables	8,026	3,748	11,774
Cumulative (1988)	250,794	111,261	362,055
89 Increase over 88	133.7%	148.0%	138.1%

Chairman PICKLE. Thank you, Mr. Murphy. We appreciate your testimony, and we appreciate that you condensed your very important testimony in a short time so that the members can ask questions.

Now, let me go first to two of these things, and I want to ask the members to stay within the 5 minutes. We will come back to each one of you after completing your initial questioning.

We thought everything looked favorable this year for taxpayer services. I like the fact that the Internal Revenue Service is emphasizing taxpayer service, trying aggressively to offer service to the public. We have not done that very much in past years, and so I think it is good that you are doing it. It is good that we bare our souls to the public on what kind of job we are doing, and the fact that we are trying to do it is commendable.

We thought we were going to have a better season because you had suggested last year that you would have more permanent employees. I understand about 1,500 temporary assistors were made permanent. Also, you put on, you said, 15 percent more assistors. Now, this is the second year that we have been testing the same tax system without any change. So why is not the accuracy rate improving?

Mr. MURPHY. Well, you are right in what you said about the expansions, Mr. Chairman. As far as the reason that the accuracy is not improving, I believe it has to do with the fact that the improvements are still taking place with the increases that we have made. I also feel, as I mentioned in my testimony, Mr. Chairman, that the employees are still trying to get comfortable with the new law and the changes that take place.

As far as why things cannot improve, I really do believe that there still is the opportunity to raise that trend higher. As far as the specifics on it, all I can tell you—and I will ask Mr. Brennan to help me on this—is that we monitor this on a weekly basis and as soon as we see any troublesome indications, we conduct morning group meetings and provide job aids and other types of activities to try to get the errors corrected as soon as possible.

Chairman PICKLE. Mr. Murphy, you say that you are just not satisfied with these kinds of rates and you believe that you can improve them. Mr. Murphy, we demand that you improve them. It is not enough to just look askance at this problem. It is a serious problem.

Mr. MURPHY. I recognize that.

Chairman PICKLE. And the taxpayers are going to be confused and frustrated about these results. When they know that at least 25 or 30 percent of the time or more they get incorrect answers, that is not acceptable. So it is not enough for you to say, well, we are going to do better. You have got to do better. I cannot accept "We hope to do better." We have got to do it now.

You showed an error rate of approximately 30 percent. The General Accounting Office shows an error rate of 37.6, 39, or 40 percent. For purposes of general discussion, you show a 30 percent error rate, GAO 40 percent. There is a 8 or 9 percent difference in there. Why is that?

Mr. MURPHY. Mr. Chairman, let me start on that and then turn it over to Mr. Brennan.

As I mentioned we are in agreement with GAO that 62.4 percent of the answers met our standard. The reason that we have a difference is that we feel that only 29 percent of our answers cause the taxpayer to file an incorrect return.

GAO, on the other hand, respectfully disagrees with that position, Mr. Chairman.

Chairman PICKLE. Did GAO complain to you as to your interpretation versus their interpretation or the approach that either or both of you used? Mr. Brennan.

Mr. BRENNAN. I would not say complain. There were many meetings that we had, and we agreed to disagree. We clearly knew that they did not agree with our figure.

Chairman PICKLE. Well, when you say they did not agree, did they protest the way you conducted your survey as compared to the way they conducted it?

Mr. MURPHY. Mr. Chairman, let me jump back in on that one. There were discussions, as Mr. Brennan said, and we agreed to disagree. But when it got to the point of doing anything public with that, our communications left much to be desired. As Paul Newman said in Cool Hand Luke, "There has been a failure to communicate here." But there was not a question of a major spat going on here.

We took the position that a wrong answer is the key to this, but it was not a question of complaining. A lot of the concern that has arisen took place as a result of the action we took last Friday.

Chairman PICKLE. Well, I think it is important that if you have two different surveys being made, both agencies ought to work from the same general set of questions, same standards. And if there is any kind of variance, we the Congress ought to be advised about it.

I can see why you would have different interpretations, but I do not know how important that is. You are squabbling on about how bad a job you did, whether it was 30 percent or 40 percent. Or, to put it in blunter terms, we are talking about whether we should give you a D or a D minus. I do not know why one agency would get so haughty about the type of examination it has made. I do not think there is any intent to deceive. But I just think we have got to be positive that you go by the same rules, because otherwise the two committees will be confused themselves. That must be avoided.

Mr. MURPHY. Mr. Chairman, I agree with you. And as I said, we did not have good communication on this one. We have apologized to GAO on it. I agree with you that in working together we can improve this system, and we certainly value our relationship with GAO.

Chairman PICKLE. Now, I am trying to find out why this has happened. You say, well, we have had 1,500 changes in the last 10 years, and we have changed the Tax Code. We have basically changed very little of the tax laws since 1986.

One of the error rates GAO showed in its survey was in the area of sale of one's home where you had a 52 percent error rate. We have not changed residence sales tax law for years. How do you explain why you have 52 percent error rate on that? That has not been subject to change? How do you explain that?

Mr. MURPHY. Mr. Chairman, there was a change, a slight change made on that, but I am going to ask Mr. Brennan to respond to you on that.

Mr. BRENNAN. Let me back up just a little bit. This year, we did make a major change in our system. As we mentioned earlier, we worked very closely with GAO, and we changed from approximately 29 questions to 62 questions, trying to get a broader base. So we did make that change in our system.

In retrospect, this year, we did start up the system a bit later than we did last year in trying to work out our——

Chairman PICKLE. Mr. Brennan, I hear you, but I cannot understand. When there has been no basic change in the law and the questions are coming in, and you have moved from the temporary assistors to a permanent system, still you have got a 52 percent error rate in questions pertaining to sale of residences. Now, that does not make sense.

Last year, we asked you whether, when the phone calls come in and it is in an area where it was technical, you could refer those calls to the technical division in some way? You said, "Yes, we could do that." Are you doing that now?

Mr. BRENNAN. Yes, sir. We are.

Chairman PICKLE. So that makes your 52 percent rate all the more unacceptable when you have referred it to the real experts, and then they still get a 52 percent error rate.

Now, how do you explain that?

Mr. BRENNAN. The problem is, sir, we still have not reached the point we want to reach on our first-line assistors recognizing what they have to refer, doing the probing that they should be doing to recognize those questions that they cannot answer. That is still the key area that we have not been able to make satisfactory progress in.

We are hoping that the diagnostic center we put in this year——

Chairman PICKLE. Well, I have got a lot of other questions.

Mr. MURPHY. Mr. Chairman, I just want to make sure that we all are straight on the home mortgage issue. I believe there have been two changes on the home mortgage deduction since the Tax Reform Act of 1986. Again, I am not using that as an excuse, but there have been many changes.

Chairman PICKLE. Well, there was a cap, and there might have been some small changes, but not anything major.

Mr. ANTHONY. Not on the gain of a sale.

Chairman PICKLE. Mr. Anthony is suggesting there has been no change on the gain of a sale.

Mr. MURPHY. That is another area. I agree, Mr. Anthony. There are areas that need a lot of attention. I agree with you.

Chairman PICKLE. I am going to recognize Mr. Schulze. But I will just say to you again: As one person representing a congressional district where the call site in my area shows a 67 percent error rate, and then goes down to 59 percent and down to 54 percent and the arrow is just going down, and if we conducted a survey a couple of weeks from now it may fall below 50 percent. Mr. Murphy, that cannot be accepted. This Congress will not accept it. Now, to do it, we have got to make some requests. I am going to yield because I want to stay within my time. But if you want these other improve-

ments and other equipment, you have got to ask for them. If you want personnel, you have got to ask for them.

Mr. MURPHY. I would make just one comment, Mr. Chairman, on the site that you mentioned. The latest figures show that while it is not back up to where we want it, it is moving in the right direction.

Chairman PICKLE. Mr. Schulze.

Mr. SCHULZE. Thank you, Mr. Chairman.

Gentlemen, let me follow along that same line of questioning. It is interesting to me because I have recently introduced a bill which would eliminate the capital gain tax on principal residences. This, of course, would eliminate the continual recordkeeping that the individual homeowner has to keep over a long period, sometimes 30, 40, 50 years. I can understand why it can be somewhat confusing on individual items which, when you keep records that are that long, because it is not an area that is extremely simple. If you take someone off the street, give them some training and put them on the phone, it is very difficult for them to do this sometimes.

I believe that one of our goals has to be simplification, and that is more our problem than yours. I am somewhat sympathetic in that area.

One other question along that line. What is the salary scale for a telephone assistor?

Mr. MURPHY. I will ask Mr. Brennan to comment on that, Mr. Schulze.

Mr. BRENNAN. It is approximately $15,000 per year. Let me just give you the exact figure.

For a permanent Taxpayer Service Specialist, our highest graded people, grade 8, it would be $23,000; for a Taxpayer Service Representative grade 6, it would be $18,000 in round numbers.

Mr. SCHULZE. So somewhere between $18,000 and $20,000. We have to assume that their training and level of education has to be as high or higher than the average in the country. If we have the tax law so complicated that it is difficult for the IRS employee to understand, I believe we have to be a little introspective and say: What can we do to create more simplification, not just sort of lash out—and everybody likes to whip the IRS, and I am part of that at times. But we also have to say: Are we doing something which causes this error rate? I believe the lack of simplification is part of it.

I would like you to refer to your budget. I understand your budget request is $5.5 billion instead of $5.2 billion, which is about a $300 million increase. Does that not still leave you behind? You had an increase technically last year in expenses of about $350 million. How are you going to do this modernization which is sorely needed? Are you just going to take that $300 million and put that all into modernization?

I believe you are going to need more money, and I know perhaps you are in a difficult position along those lines. But how are you going to do it all with $300 million?

Mr. MURPHY. Mr. Schulze, you are quite accurate on the 1990 budget. It is difficult for me to respond to that without sharing with you that I have recently testified before the House Appropriations Committee and the committee in the other body on the sub-

ject of 1990, where we do have a request for an increase, as you pointed out, of $56 million for taxpayer service, $102 million in the information systems area, with about $80 million of that in the modernization program. That increase, as I mentioned earlier, is essential.

Mr. SCHULZE. Are those the up-front costs, or is that actually getting into purchases?

Mr. MURPHY. That is getting prepared for the purchases. I believe in 1989 we had several million dollars in for the same purpose, but it is absolutely essential for us to go on. So your point is well taken.

The problem with right now, though, Congressman Schulze—as I testified—in 1989 we are dealing with a serious problem as a result of having to absorb the January pay raise and postal increases, space, special hiring rates, things like that. We are trying to deal with that, Mr. Schulze, in 1989, and still commit to you and to the chairman and the other members of the subcommittee that we want to be held accountable for improving those accuracy rates. But where it comes back to is that we have placed some restrictions on hiring right now. We have taken a lot of management actions, but we have kept certain things sacred: the delivery of the taxpayer service program and the returns processing program. We have tried to maintain a balance between our service and our enforcement sides of the house.

We are not furloughing permanent employees or anything like that, but it is a very delicate balance. And we are trying to work ourselves out of it to put us in a better position for 1990.

Mr. SCHULZE. Mike, are you able to improve your computer status modernization as rapidly as you would like? Perhaps sometime we should sit down and talk about it. I think it is extremely important.

I am hearing from private industry that their equipment is more sophisticated than yours, and sometimes they have trouble transferring information to you because of your lack of sophistication. So I believe it is extremely important that we make sure that your equipment is in a position to accept this information.

Mr. MURPHY. Congressman Schulze, you say it better than I say it, because I agree with you and you are right. There is an impact that happens as a result of 1989. If you recall, we moved over $50 million in order to provide the service that the taxpayers are entitled to. As a result of doing that, there has been some slippage in some of those information systems projects. But the modernization plan that we have in place can still be achieved with your active support. And we really appreciate that.

Mr. SCHULZE. I would like, some time in the next couple of weeks, to sit down and go over those projections with you and where you are going.

Mr. MURPHY. I would be happy to do that.

Mr. SCHULZE. A couple of other quick questions. If you are going to make 15,000 calls to your centers, do you have any idea how many the GAO makes?

Mr. MURPHY. I really do not know. You mean as part of their independent test?

Mr. SCHULZE. Yes.

Mr. MURPHY. I really do not know, Congressman Schulze.

Mr. SCHULZE. Can we assume they probably make $10,000 to $15,000?

Mr. MURPHY. I doubt very much.

Mr. SCHULZE. I am just wondering. You know, I pick up magazines and newspapers, and they are all making telephone calls to the IRS and doing their own little surveys. Gosh, if we have 50,000 or 100,000 calls being made for surveys, that is bound to be a source of delay and frustration. I am not saying that we should not check up on you, but I would hope that we do not reach the point where we have got more people calling in from the media and checking up on the people than we do taxpayers trying to get through to get the real information.

I would also think that when you call on a survey, you probably do design somewhat of a tricky question so that you can try to determine the depth of knowledge of the individual with whom you are speaking. So that does give me some concern, and I would hope that perhaps the media around the country could use your figures and GAO's figures and not have, as we had in the past several years, everybody running out and making their own little surveys.

I have one final question, and that is a parochial one. Now that you have additional flow into Philadelphia, how is the Philadelphia Service Center doing? I know that the rate has increased in there, and I just want to see how they are making out.

Mr. MURPHY. I believe, Congressman Schulze, that the Philadelphia Service Center is doing quite well. I am going to ask Mr. Brennan to comment on that. I just want to assure you that it is the current leadership in the Mid-Atlantic Region that is accomplishing a lot of that, not the past. All right? I am speaking of Mike Murphy.

Mr. BRENNAN. Let me just assure you that the Philadelphia Service Center is processing almost exactly on schedule.

Mr. SCHULZE. The additional flow that is going in there, did we give them additional help?

Mr. BRENNAN. Yes, sir. We scheduled more people and more processing, and they are operating almost exactly on schedule.

Mr. SCHULZE. Thank you. Thank you, Mr. Chairman.

Chairman PICKLE. The Chair recognizes Mr. Chandler.

Mr. CHANDLER. Thank you, Mr. Chairman.

Mr. Murphy, in your testimony, you discussed on page 14 the complexity of the law, and, I believe importantly, in an area that is being overlooked; namely, the difficulties in recruiting and retaining a work force in a competitive labor market. Could you comment about that and the problems you face and what you think you are going to face in the future? Do you see the same kind of talent drain from the IRS that we are seeing in many of the other Federal agencies?

Mr. MURPHY. Congressman Chandler, you certainly have hit on a very, very serious problem. As far as what we are doing, we have the same projections that you do that the work force is going to change very drastically right on up into the year 2000. The difficulty of trying to attract people and retain them has to do, as Mr. Brennan testified, with the amount of the salary. The other key to it is the proper amount of training and, frankly, what kind of an

employer the Internal Revenue Service is for over 100,000 people. With our commitment to quality and customer service, we are seeing a real change in employee pride in the organization.

As far as how we deal with it in certain areas—and I am going to ask either Mr. Brennan or Mr. Wedick to add to what I tell you—the short-range approach to it is to try to deal with geographical situations where, say, in New York we might be able to arrange a special salary rate or in Los Angeles. We do things like that.

But the other part of it is that the modernization of the system, Congressman Chandler, also has a bearing on the people-labor intensive work versus the amount of work that technology can handle. So we see some changes, and we have to be able to move people from one skill to another.

Let me ask Mr. Brennan to see if he would like to add anything to that.

Mr. BRENNAN. Let me just make one comment, a bit anecdotal, perhaps, but in one of our sites, which is not having a very successful time, we have had an attrition rate in our classes during February as high as 35 and 40 percent.

Mr. CHANDLER. What site is that?

Mr. BRENNAN. I do not recall it right now. It is not the chairman's site; I can guarantee that. But that is what happened. I just use that as an example of what can happen to us in terms of retaining competent help.

Mr. CHANDLER. Do you think that the demands on the IRS are perhaps even unique within the Federal service and would require some attention, perhaps not by this committee but the Post Office and Civil Service Committee to address, in terms of retaining competent employees?

Mr. BRENNAN. We do work with trying to analyze and prepare requests, as Mr. Murphy mentioned, for special salary rates for certain parts of the country where it is hard to retain——

Mr. CHANDLER. Do you have enough flexibility now?

Mr. BRENNAN. It is a long process. We would certainly appreciate the help of any committee in this regard.

Mr. CHANDLER. All right. I have just gone on that committee, so perhaps I could be helpful.

Mr. MURPHY. Congressman Chandler, I think your offer to provide whatever help you can would certainly be appreciated. We could always use more flexibility in those areas, and we will be happy to have somebody discuss that with you.

Mr. CHANDLER. All right. I would like to ask about the electronic filing. As I understand the system now, this is primarily a taxpayer going to someone who is a tax preparer who has gotten the necessary software and has complied with your requirements for whatever communication takes place. Could a taxpayer also come to the IRS itself, to a branch office, and file electronically? Is there any walk-in kind of service for electronic filing?

Mr. MURPHY. Congressman Chandler, at this time there is not. But as I mentioned in my testimony, with a new program like this that we think has unlimited capability, you just never know. But in answer to your question, we do not have that kind of capability. You must go to an accepted software user in order to file your return electronically.

Mr. CHANDLER. Is electronic funds transfer for returns only available to electronic filers?

Mr. MURPHY. I am not sure of that. I believe that it is only in the districts where you have the electronic filing capability. But let me verify that with Mr. Wedick. John.

Mr. WEDICK. That is correct. At this point, direct deposit is limited to electronically filed returns.

Mr. CHANDLER. Is there any reason why you could not allow that for paper filers? That seems attractive to me.

Mr. WEDICK. That is one thing that we are looking at along with a number of other enhancements to both the filing of paper returns and electronic returns. For example, we are testing it this year and hope to have it available on a much broader scale next year—something called the answer sheet return, which basically is a return that can be prepared using your own home computer. You produce, in addition to the return, an answer sheet, which simply has the line numbers and the amounts, that goes on top of the return. The return is sent to IRS in a special envelope. We will scan that answer sheet using optical scanning devices, and then process that as an electronic return. In a sense, it is simulated electronic filing which would be available to the individual taxpayer.

Mr. CHANDLER. I believe that would be a fine addition to the Service. A lot of people would prefer that, and I believe there would be greater efficiency in that to the IRS as well.

Mr. WEDICK. That is correct.

Mr. CHANDLER. I see my time is about up, Mr. Chairman. Thank you.

Chairman PICKLE. Thank you, Mr. Chandler. You asked some pertinent questions.

I think we must ask ourselves what is going to happen to the regular mom-and-pop type of tax filer in this modern world of electronic filing. Will they, at some point, have to be required to buy a great deal of expensive equipment and to learn a new process that they do not know?

Somehow, you have got to bridge that gap, because we cannot be unfair to those people. We have got to encourage electronic filing. It is the wave of the future. But, I do not want to see unfairness to the little fellow.

Mr. CHANDLER. Mr. Chairman, would you yield on that for just one more quick one?

Chairman PICKLE. Mr. Chandler.

Mr. CHANDLER. As you know, the Bell Operating Companies are asking for the ability to provide information services. I am wondering if the IRS is working with telephone companies around the country to facilitate greater utilization of the electronic filing.

Mr. MURPHY. I believe we are, Congressman Chandler. I think Mr. Wedick has more detail on that subject.

Chairman PICKLE. The Chair recognizes Mr. Dorgan.

Mr. DORGAN. Thank you, Mr. Chairman.

I would like to ask a question about leadership down at the IRS. I know that Commissioner Gibbs is gone, and you are serving in the interim. I frankly have been concerned about the pace at which all appointments have been filled in the new administration. This is not something you can respond to very well, but I note that even

in the Internal Revenue Service we have a Commissioner who has gone, and we do not yet have a new Commissioner appointed.

Is that a problem for the Service? I assume that we would be much better off if we had continuity and a new appointment, a new Commissioner, in the middle of a filing season. What kind of problems are you experiencing down there without a Commissioner?

Mr. MURPHY. Congressman Dorgan, I think any time that you do not have permanent leadership in an organization as large as ours that it is a problem. As you probably are aware, during the last several administrations there usually has been a gap between Commissioners. The fact that it came during the filing season is unfortunate, but on the positive side of that, I have been a district director in two States, a regional commissioner in our Mid-Atlantic Region, and the Senior Deputy Commissioner for the last 2 years. Mr. Brennan has been a regional commissioner in New York. Mr. Wedick has run most of the functions, I think, in the National Office. Between the three of us, I would say that we have a major impact on whether the Internal Revenue Service moves forward or stands still.

We look forward to having a Commissioner and Chief Counsel in place. But in the meantime, let me just assure you, Congressman Dorgan, that we feel quite capable continuing the management of the Internal Revenue Service.

Mr. DORGAN. And my point was broader than this.

Mr. MURPHY. I realize that.

Mr. DORGAN. My point is that there are many, many areas all across Government with unfilled appointments, and one would have expected much more aggressive activity on the part of the administration to get their team in place and going.

Let me ask a question about the Reagan budget, which I think carries over to the Bush budget. It proposed a fee for telephone assistance, as I understood it. Now, to the extent that I have been able to determine it, that is still a carryover in the Bush budget. As a former tax administrator, it seems to me that the best way to infuriate most of the American people would be to say to them: A, we have got a complex tax system; now, B, we are going to charge you for asking us questions about the system.

What is your response to that?

Mr. MURPHY. Well, maybe C might be the reason that the chairman has been talking to me about how accuracy fits into it. My comment is really this, and I am going to be very careful about not using the word "exploration." On that subject of user fees, you are correct, it is in the budget. It was in there as a result of discussions between IRS and Treasury and OMB. The idea was to find out if there are any possibilities of where this might be feasible to work with telephone companies and other people, Congressman Dorgan, come back with recommendations and then get to the policy issue.

Beyond that, I know that the groups have been working together. I have not received any recommendations on this subject at this time.

Mr. DORGAN. I must observe that I think it is a terrible idea to charge a fee for answering questions that are almost required to be asked by taxpayers because of the sheer complexity of the tax

system. I think that is a terrible idea and I would guess that the idea would not get a great deal of support here in Congress, and I wanted to hear your observations about it.

Let me move on to another item. What increase in personnel, what level of increase in personnel in taxpayer assistance and telephone service are we experiencing this year over last year? Do you have any numbers in those two areas?

Mr. MURPHY. I do not have the numbers, Congressman Dorgan, but maybe Mr. Brennan does. Let me ask him.

Mr. DORGAN. All right.

Mr. BRENNAN. The numbers, in terms of the telephone, are approximately the same this year as last year.

Mr. DORGAN. So, no increase in the ability to respond to telephone requests?

Mr. BRENNAN. Yes. What we forecast and what is happening are less telephone calls this year than last year.

Mr. DORGAN. OK.

Mr. BRENNAN. Last year being the first year of tax reform, we did get more calls. We forecast——

Mr. DORGAN. Well, I am talking about manpower levels, no increase in manpower levels?

Mr. BRENNAN. No increase in the staff level for taxpayer service on the telephone.

Mr. DORGAN. How about taxpayer assistance?

Mr. BRENNAN. I am sorry, the whole taxpayer systems area is approximately the same this year as it was last year.

Mr. DORGAN. The reason I asked the question is, you know, we had a task force that we empaneled with I think the best minds in town on this subject, two former IRS Commissioners, Treasury, Joint Tax, private sector folks who really understand this issue of what do you do, and what do you invest in to enable the Internal Revenue Service to better collect the money it is supposed to collect.

What we are trying to do is figure out how you narrow the tax gap of $85 to $100 billion a year that is now uncollected. Their recommendations—and we studied this for a good many months, almost a year—their recommendations were that over a 5-year period we would need to make a substantial investment in new taxpayer assistance and telephone service and attendant personnel, about 19,000 people, because we have had a tremendous erosion in the ability to provide taxpayer assistance and service over the years, and that a component part of narrowing the tax gap is not just enforcement, but also service. Both of them are revenue raisers, if done right.

Your response is that we are experiencing no increase in personnel with respect to taxpayer assistance and taxpayer service, and I am saying that is a big mistake, in my judgment, in terms of what we are going to be collecting, and that coincides with the headline in the daily paper here in Washington—actually there are two—the Washington Post today has a headline, "Cash Crisis Hobbles the IRS, As Agency Workload Grows."

Most of us have understood what has happened to your agency, especially in the early to mid-1980's. The fact is that the Reagan administration was squeezing that agency like a lemon, because it

believed that all government was bad, even its tax-collecting agency, and I am not sure we have recovered from that. We have certainly not recovered to the point where we are building the enforcement and the assistance capabilities necessary to collect what is out there to collect. At a time when we need additional revenue, there still floats out there nearly $100 billion a year. The proper investments in enforcement and service—and I emphasize "and service"—could in my judgment accomplish much, much more for this Congress and for the country in reducing the deficit than the kinds of plans we have seen from the last couple of administrations and from some, frankly, in Congress here who do not understand the issue.

Mr. MURPHY. Congressman Dorgan, you covered a couple of subjects here, and let me go back to one to be sure. I think we did have an increase in staff, staff years in taxpayer service, and I would like to submit something for the record on that, just rather than say we are standing still.

[The following was subsequently received:]

For the 1989 filing season we have increased the number of toll-free telephone lines, the number of tele-tax lines, and have maintained approximately the same number of toll-free assistors. As we did last year, we made it easier for taxpayers to contact the IRS for assistance. The number of lines for toll-free tax assistance was increased by 6 percent over 1988. Tele-tax lines were increased by 10 percent over 1988. Some telephone traffic was permanently re-routed in certain geographic areas to provide for improved accessibility.

In FY 1988, we answered 38.5 million toll-free calls. This year, we expect to answer 37.9 million calls. This drop is largely because we expect taxpayers to become more familiar with the new tax law this year and because more and more taxpayers are using the tele-tax system to access pre-recorded tax information.

Given the demand we expect and the staffing we are making available through reprogramming from other areas, we intend to provide an 85 percent level of service for the 1989 filing season.

As we did last year, we continue to provide extended hours of service and are providing toll-free service on Saturdays.

As to your point about what you saw in the papers, I did testify earlier on how we are trying to deal with the 1989 problem, and you are right about the balancing effect between service and enforcement. As Larry Gibbs testified before, the key to the leadership that he had been providing for the last few years really depends on having the taxpayers that want to comply get the proper service. As a result, they will pay in more revenue. We also need to have an enforcement arm that is well-prepared and can deal with the tax gap problems that you are referring to. What it takes is the two of those to come together and to have the resources in which to do it.

I agree exactly with what you are saying.

Mr. DORGAN. Well, I might make one additional comment. The world might be a safer and a better place without the Office of Management and Budget, I feel from time to time. The Office of Management and Budget insists and historically has insisted that if you invest a dollar in taxpayer assistance, you have a net loss of a dollar. That has historically been their position, which I think is fundamentally wrong, and we in Congress have our work to do, it seems to me, to make the right investments to help you do the job that we want you to do.

The chairman is quite correct when he says we demand clearly, if we provide the resources, then we expect and demand that the Internal Revenue Service perform the kind of service that we want them to perform for the American public.

Mr. MURPHY. Congressman Dorgan, on the point about OMB's involvement, we do have under study the very subject that you mentioned about the impact of taxpayer service. In fact, OMB and the Treasury have been very supportive of this agency in our efforts to get that balance going. We moved from 70 percent enforcement to 30 percent service, to a 60–40 balance, so we are getting support there.

Chairman PICKLE. Mr. Murphy, I have a question that I would like to continue with you in line with what Mr. Dorgan was stressing. The paper this morning, the headline reports that your work is being hobbled, that you do not have the proper forms, you do not have enough people, you do not have enough copier machines, and you are running out of pencils and paper. You testified that the tax-filing season was going well and this has not been a problem. What is your response to the allegation that the GAO charged yesterday and what is your comment on the report that you are that strapped for money or are you having that much trouble? Is that hampering your filing system?

Mr. MURPHY. Mr. Chairman, the discussion that took place yesterday between the IRS and GAO was more on the subject of accuracy. Unless I am misunderstanding your question, the item that was in the paper this morning regarding our budget situation and a shortage of paper, is the item that I did comment on earlier, but let me make a statement on it again, because I think it is very significant.

We do have a problem in 1989, Mr. Chairman, that we are trying to deal with. We are trying to minimize any impact that it would have on our programs, as well as on the employees who feel that they do not have the tools with which to do their job. It was for that reason that we decided: One, that the taxpayer service and return processing program objectives would be met; two, that we would not restrict case-related travel, and the reason for that is to keep our enforcement people doing their job.

I am aware of a problem of a paper shortage that took place in our national office. I believe, Mr. Chairman, that has been resolved. I believe the key to our success of getting ourselves positioned for 1990 rests with the cooperation of our employees, our union, and the management of the organization. If you would like more detail on this one, I would be happy to submit it to you or offer Mr. Wedick to make further comment.

Chairman PICKLE. Mr. Murphy, we are trying to establish facts.

Mr. MURPHY. I know you are.

Chairman PICKLE. The charge has been made that you do not have enough office supplies, do not have enough personnel, that you are literally strapped, and that you are operating as a second-class agency. Are these shortages major, in your opinion? Are you being affected in the taxpayer service program?

Mr. MURPHY. Mr. Chairman, with the exception of the item that we have already discussed, which is the need to improve our accuracy and to have the tools to try to do that, I believe we are being

extremely effective in managing the programs of taxpayer service and returns processing, and I am seeing minimal impact on the enforcement program.

Is it a piece of cake? No, Mr. Chairman. We are dealing with it. We are still trying to manage within about a $50 million problem. We hope to have that achieved by the end of this fiscal year.

Chairman PICKLE. Mr. Murphy, I recognize that this year your agency is under more difficult circumstances than normal in that you had to absorb a pay raise, you had to absorb additional postal costs, you had to make up health retiree costs and higher salaries in certain levels, and you got $100 million less than you had requested.

Now, almost every year for the past 6 years that I have been on this committee, this committee has asked for more money and gave you more money than you were ever willing to ask for down the street. You are caught most helplessly between the needs of the IRS and the OMB.

This last year you did not get it although you requested it, as we requested it, you were overruled by OMB, they said no, you have got to be treated the same as all the other agencies. Now, I accept the fact that you are operating with more difficulty, but all agencies are having to operate in a very strained manner, because of these cuts.

I am simply trying to say to you that it is disturbing to me. We will hear from the GAO, and I am going to ask, Mr. Murphy, that you stay here and hear what their testimony this morning, you and your staff. I want to see what their statements are. When they make statements, though, that you are being hobbled and you are really being cut up and you cannot operate efficiently, travelwise and in almost every respect, is that a factual, correct statement in a major number of instances? Is it materially affecting the job that you are doing down there? We need to know that. You must be able to respond to us on that.

[The following was subsequently received:]

The fiscal year 1989 budget is $5.2 billion. However, the sum is approximately $50 million less than is needed for the remainder of the fiscal year. The budget for this fiscal year was developed beginning 20 months before the fiscal year began. We must absorb new costs that are unbudgeted—the January 1989 pay raise, higher government contribution to employee health plans, and the postage rate increase which went into effect last spring. We are also making use of geographic special salary rates to improve retention of employees, the cost of which we must also absorb.

Wherever we can, we are reducing less essential expenditures in areas such as travel, space acquisitions, employee relocation, training, equipment purchases and ADP expenditures. We have also restricted hiring for most of the year, except in returns processing and taxpayer service during the filing season. We have given priority to processing returns timely and answering taxpayers' questions. Since Examination staff was at a high level entering this fiscal year, we don't expect any significant reduction in the number of returns that were planned to be audited this year.

Mr. DORGAN. Mr. Chairman.

Chairman PICKLE. Mr. Dorgan, I will yield.

Mr. DORGAN. Let me follow up with two items, if I might. One, with respect to the question of the OMB as I am less charitable than Mr. Murphy would be. I noted in your testimony, Mr. Murphy, at page 11, you are talking about automated taxpayer

service systems and an attempt to provide an increase in accuracy and productivity and so on.

My understanding has been—and this is symbolic, I think, of what you find when you deal with OMB. My understanding has been that there is no real increase in fiscal year 1990 for automated taxpayer service systems, despite the fact that you requested one and apparently were turned down by OMB.

Mr. MURPHY. Congressman Dorgan, I am told that is correct. I mentioned earlier about—are you talking about 1989, or are you talking about 1990?

Mr. DORGAN. Fiscal year 1990.

Mr. MURPHY. OK. Mr. Wedick tells me that what you say is true.

Mr. DORGAN. And the point I am making is that, you know, I do not want you to feel charitable about OMB, just because you work with them. The fact is they have some responsibilities and we have some responsibilities and you do, to do the right things for the American taxpayer, and I think all of us are being short-changed with respect to the kind of decisions that have been made about investments in the Internal Revenue Service, and at least part of that responsibility rests in my judgment with OMB over recent years.

Mr. Chairman, if I might make one final point, one that I wanted to make to Mr. Murphy especially this morning, and this is not on taxpayer assistance. Mr. Murphy, in the coming days, you will be releasing regulations on the diesel fuel issue, and you are well familiar with the enormous controversy over the diesel fuel tax, particularly for farmers, off-road users.

The initial regulations that were proposed would not have comported with the intent of this committee, and I know, with respect to the volume and transactions, that you are reworking at. I want to say to you that members of this committee will be very upset if we do not see regulations that solve this problem.

The legislation that I and others pushed, including the chairman, to solve this diesel fuel tax problem, the legislation we pushed is quite clear. We know what we want to have happen, and we do not want regulations to come out that either deal with volume or transactions in a way that excludes a whole range of wholesale distributors from being able to sell tax-free to off-road users. So, please take that back and do not issue regulations that cause us further problems. Issue regulations that do what we want done with the legislation we passed last year.

Mr. MURPHY. Congressman Dorgan, I appreciate your calling that to my attention. I am aware that those regulations are still with us, and I will pay particular attention to the item that you mentioned.

Mr. DORGAN. Thank you very much.

Chairman PICKLE. The Chair would like to reclaim its time now.

Mr. DORGAN. I thank the Chair very much.

Chairman PICKLE. I have two or three questions, Mr. Murphy, that I want to continue with. The GAO has testified that they had ordered complete sets of forms from different offices. Of the 35 tax form packages that they ordered over the toll-free system, in only 4 cases were those orders complete. Is that an accurate appraisal, or do you know?

Mr. MURPHY. Mr. Chairman, I am going to ask Mr. Wedick to comment in just a few seconds. If there is an accuracy rate of 10 percent on anything, I can assure you that presents a very, very serious problem. I would have Mr. Wedick comment on it.

Chairman PICKLE. Mr. Wedick.

Mr. WEDICK. Mr. Chairman, it is my understanding that the GAO ordered 390 forms, actually 39 orders of 10 forms each. They received a total of 348 forms out of the order. Contrary to our procedures, they did not receive any indication as to why the remaining 42 forms were not in the order; for example, we were out of stock, form was obsolete, et cetera.

Now, our three forms distribution centers, just to put this in perspective, have processed some 8.5 million orders so far this year. We have in our forms distribution centers three systems to focus on quality, and these come really as a result of your concern, the concern you expressed last year.

The three systems are: One, Mr. Murphy already mentioned, is a random sampling of orders just before they go out. That showed that we had a 4 percent error rate. A second system uses 30 volunteer IRS employees who shop the centers by phoning and writing in orders. They actually make 3 telephone calls a week for orders and they have 14 mail-in orders per week also. They get those orders and turn them around and send them back to us in Washington, so we can determine how well the centers are performing. That system started to show us that we had a problem with orders which were for the forms which are less popular, the ones that usually are not ordered frequently. We have some 80 very popular forms, and the remainder are subject to less frequent orders—that system also indicated problems with orders involving a fair quantity, say, for example, 10.

This ties in directly with the GAO findings, and so the bottom line is yes, we have a problem with those kinds of orders. What are we doing about it? We have immediately increased the sample size on those particular orders so that we can get to the root cause of why it is we are not performing that well with that particular kind of an order.

Chairman PICKLE. Mr. Wedick, I was going to comment that it sounds to me like you are explaining why you did not send out full orders in the packages, rather than challenging it, and I think you just said that you have got to do a better job on it.

Now, in the area of electronic filing, Mr. Murphy, I understand last year that the Ogden Service Center discovered the first questionable refund scheme involving electronic filing, and in one case a group of people had filed 35 fictitious returns electronically and that they received refunds of about $63,000.

Now, my question to you is when you get an electronically filed return, how do you examine it to make sure that it is genuine?

Mr. MURPHY. Mr. Chairman, I am going to ask Mr. Brennan to add to this, but just the very fact that we did discover this was really reassuring to me that switching into modern technology—and I believe that is the basis for your question—means that there are still people that are going to try to beat the system, if you will, and I think that was a real message out on that.

As far as the specifics on how we examine it, let me ask Mr. Brennan to comment on that.

Chairman PICKLE. Mr. Brennan, try to give us a rather short answer to the question, will you?

Mr. BRENNAN. There are two or three cases we caught around the country through looking at the W-2, which comes in separately, and we were able to stop last year, I believe it was, three schemes that our centers came up with. But I will be glad to submit something more detailed for the record.

[The following was subsequently received:]

Electronic returns are subjected to all of the same checks and tests as all paper returns to ensure validity.

The specific case referred to occurred in North Carolina and was discovered by the Cincinnati Service Center. The principals in that case were arrested.

We are not aware of any fraudulent schemes involving Electronic returns thus far in 1989. There were a total of 29 such schemes (22 in Ogden; 7 in Cincinnati) involving 116 returns in 1988. As a point of reference, this compares very favorably to the 124 schemes (73 in Ogden; 51 in Cincinnati) involving 408 fruadulent paper returns filed in those centers during the same period.

Chairman PICKLE. Well, is the electronic filing system going to lead to more fraudulent submissions or claims?

Mr. BRENNAN. Our criminal investigations people are working with the electronic filing office, to make sure that we have procedures in place so that we can stop refunds there, like we do with the manual procedure.

Chairman PICKLE. Well, the General Accounting Office is going to testify next. But, in testimony submitted to us, they say that you have software problems. In many instances, when you checked returns, you had to make paper copies from the terminal with the return information that came in. You had to go back and reconstitute it in paper form to check the accuracy. In how many instances did that occur over the country? Do you have any idea?

Mr. MURPHY. I am aware there were early problems, Mr. Chairman, but I do not have that. I would be happy to submit that to you for the record, though.

[The following was subsequently received:]

Earlier this filing season (from January 13–February 23), we used paper print outs of returns to correct errors. Of almost 650,000 returns received at that time, there were a total of just over 16,000 corrected in this manner. It should be noted for the record that this process did not, in any way, delay any refunds. All errors were corrected within the filing cycle.

Chairman PICKLE. Well, are you saying that your software problem has been corrected and that you do not have that problem now?

Mr. MURPHY. Mr. Wedick has a comment on that.

Chairman PICKLE. Mr. Wedick.

Mr. WEDICK. We had a software problem last year, and the software problem did not relate to the processing of the return per se but, rather, to the internal handling of it, that is, archiving it, as we use the term, putting it in the file and then retrieving it from the file.

We have a new system in place at this point and that new system, even though not all of the software work is done, seems to be working fine at this point and we do not anticipate, quite frankly, any problems. This has no effect, I want to underscore, no effect

on the taxpaying public from the standpoint of how soon they get a refund.

Chairman PICKLE. In effect, you are saying that the electronic filing software has been replaced and that you do not have this problem now in any major sense. Is that correct?

Mr. WEDICK. That is what I am saying, yes, sir.

Chairman PICKLE. All right. Now, Mr. Murphy, before you leave here temporarily, on the service center staffing, I had some people from my district come up recently. They said that the IRS funding and staffing levels were inadequate to handle the processing of the large growth in returns that were going to be coming in April, the next 30 days. Is that correct?

Mr. MURPHY. Mr. Chairman, Mr. Brennan has the specifics on that and I am going to ask him to respond.

Chairman PICKLE. Mr. Brennan. I asked about my district, but I think that would be true of any district all over the country.

Mr. BRENNAN. I am not aware, sir, of any of our returns processing service centers or the compliance center having any staffing problem that would affect this filing period.

Chairman PICKLE. Well, I believe one gentleman from the IRS testified yesterday, or at least made a statement, saying that the number of employees over the United States was not going to be sufficient. They could not handle the work and IRS is running short of personnel. Is that correct?

Mr. BRENNAN. Not in returns processing or taxpayer service, sir.

Chairman PICKLE. Not in that area?

Mr. BRENNAN. No.

Chairman PICKLE. All right.

Mr. MURPHY. Mr. Chairman, if there are any specifics on that, we can look into it, and we would be happy to do that.

Chairman PICKLE. I am concerned. In my particular district they had a compliance center and several of the worried were released, some of them were moved over into the service center as compared to the compliance center. I need to know, do you have sufficient staff at the various IRS centers around the country to handle the volume of returns that are going to be submitted to you here within the next 30 days?

Mr. BRENNAN. Yes, sir, we do.

Chairman PICKLE. You do. All right.

Now, I have a lot of questions I want to submit to you in writing and I am going to ask you to respond as quickly as you can, in order to move forward.

Let me ask Mr. Ford if he has any questions. Mr. Ford.

Mr. FORD. Mr. Chairman, I am going to leave all of the questions up to you. There are a list of things I guess we could put to the Acting Commissioner, Mr. Murphy, as it relates to the training and travel being reduced dramatically; I guess that materials were shipped from the IRS national office to one of the service centers in order to be copied and mailed back to Washington because there was no copying paper in the Washington office; the criminal investigation division throughout the Internal Revenue cannot purchase the 9mm guns or replace the unsecured radio system used; after removal of two photocopy machines, the Brookhaven Service Center will be left with only one photocopier; across the IRS supplies are

running low, being rationed at this point; the IRS has a questionable refunds program, with the Criminal Investigations Division of the Austin Compliance Center has been eliminated—just how serious of the eight or nine funding and staffing shortages at the Internal Revenue Center?

I think that the issue that is before this committee and what we are seeking from the Internal Revenue Service is whether or not there is a shortage problem. Also, we would like to know whether there is a funding problem at this point in time for services rendered to the taxpayers.

Mr. MURPHY. Congressman Ford, I mentioned before that we are dealing with a 1989 problem that has some very serious aspects, and one is to deliver the taxpayer service and return processing program and to maintain our enforcement programs as well. But I am acknowledging that we have a management problem to try to try to conserve resources, to insure that takes place.

I am aware of some problems similar to the ones that you reported. I would be happy to look into the specifics that you have just mentioned. Also, I have asked the management in the field of any impact as a result of the freeze or the restrictions we have put on, to feed that on in to Mr. Brennan and Mr. Wedick, so we can take immediate action on that. That is about the best response I can give you right now, but like I say, I will look into those points.

Mr. FORD. There are two things that I am concerned about. We are talking about collecting a trillion dollars, I guess, are we not?

Mr. MURPHY. That is right.

Mr. FORD. A trillion dollars.

Mr. MURPHY. A trillion dollars.

Mr. FORD. A trillion dollars. Are you going to have the capability of collecting $1 trillion that in a successful way and at the same time issues refunds to those taxpayers who are entitled to refunds? Will you be able to do that whether or not the employees of the Service will be able to identify where income taxes have been filed, when refunds should in fact go to the taxpayer. We hear from our constituents, who tell us that when they make a mistake in favor of the Internal Revenue Service, the Service is going to pick up the mistake. The mistake is automatically going to be picked up even if they in some way have made an honest mistake, they owe the Service or the Government more in taxes. I want to know whether or not it will be true for the taxpayer, that the Service will pick up the taxpayer's mistake? Some of those things that we have heard in the past indicate that the IRS employees have been told they are too busy to try to pick up the errors that are made when errors are in favor of the taxpayer.

Mr. MURPHY. Congressman Ford, on the taxpayers that file their returns during this peak filing season, the system does catch mistakes, whether they are in the taxpayers' favor or whether they are in the Government's favor. On a specific item that I——

Mr. FORD. More so in the Government's favor, though, right?

Mr. MURPHY. I am sorry, sir?

Mr. FORD. It is more of those returns are caught in favor of the government than the taxpayers?

Mr. MURPHY. I am not sure of the figures on that, Congressman Ford. It is just a consistent way of doing it, but I am not answering

your question. I just want to lead into that to assure you that the taxpayers in the high-volume filing of returns, that the system does deal with those.

There is an exception that is involved in the document matching program, where there may be certain credits on there that prior to December of 1988, that we did not pick up those figures. It is quite possible that the taxpayers would not have gotten the refund that they were entitled to. That was prior to December of 1988. I am still not completely satisfied with that specific problem, and I have asked for a complete report on it and I have received a letter from a member of the Senate and will certainly share whatever I find on that with this committee, if you would like.

[The following was subsequently received:]

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

COMMISSIONER

APR 21 1989

The Honorable J.J. Pickle
Chairman, Subcommittee on Oversight
House of Representatives
Washington, DC 20515

Dear Mr. Chairman:

The following information may be of interest to you in light of the recent publicity concerning IRS' handling of withholding tax credits that taxpayers fail to claim. This information describes our policy, the problem that occurred in our information returns program when certain of our procedures did not comport with our policy, and the corrective actions we are taking to fix the problem.

It is our policy to collect the correct amount of tax, no more, no less. As evidence of that policy, we credited or refunded almost $6 billion to taxpayers who made math errors or who had additional amounts due to them as a result of an audit or an underreported income contact. Specifically, we refunded almost $800 million in the information returns program last year.

We do categorize returns in order to concentrate our work on those returns that appear to have the best potential for owing additional tax. However, in the course of an audit or other contact with a taxpayer, we often discover deductions or credits that taxpayers are entitled to, but have failed to claim. Where this happens, any overpayments of tax are refunded to taxpayers. I think these facts illustrate that we generally carry out our policy of collecting the proper amount of tax.

However, as was recently publicized, our procedures have not always been consistent with our policy. In some cases, our procedures did not call for working cases in the underreporter program if taxpayers appeared to have a withholding credit reflected on a Form 1099, but did not appear to owe additional tax on that income. We have corrected the procedures that will be used for the Tax Year 1987 underreporter program. We will also relook at cases worked in the Tax Year 1986 program and contact any taxpayers who appear to have underclaimed their withholding credits. The Tax Year 1985 program, as you know, has already been completed and the statute expired for most of those tax cases on April 17 of this year. This makes it

more difficult to identify and correct cases in which taxpayers failed to claim all of their withholding credits. We have, however, found a way to authorize the scheduling of refunds before April 17 for taxpayers who were subject to withholding on Forms 1099 reporting pension payments. Actual refunds would be paid only to taxpayers who provide evidence that they did not claim all of the withholding credits to which they were entitled. Also, in reworking Tax Year 1986 cases, we will look at taxpayers' 1985 returns. If it appears they have under-claimed their withholding credits, we will notify them to file a claim for both years. Finally, we have made a concerted effort to get media coverage in all areas of the country to alert taxpayers to go back and check the withholding credits claimed on their 1985 tax returns. Enclosed is a copy of our national release.

I hope this information is helpful in explaining our planned changes in procedures and the steps we have taken to assure that taxpayers pay only the tax they are legally required to pay.

With best wishes.

Sincerely,

Michael J. Murphy

Acting Commissioner

Enclosure

News Release

Department of the Treasury
Internal Revenue Service
Public Affairs Division
Washington, DC 20224
Media Contact: Tel. (202) 566-4024
Copies: Tel. (202) 566-4054

For Release: 3/22/89

IR-89-35

Washington -- The Internal Revenue Service today said that it is changing procedures to be used in the information document matching program for tax year 1987 and future years to ensure that taxpayers who might not have claimed all their withholding tax will get any refunds which may be due. The changes are needed, the IRS explained, to make sure that the matching program is consistent with the agency's policy that taxpayers pay only the tax due -- no more, no less.

The IRS also gave instructions for a special claim procedure for taxpayers who may have understated the tax withheld on their 1985 returns because the period for making claims for 1985 will run out on April 15, 1989. Taxpayers will receive further instructions about the tax year 1986 matching program when the IRS completes a review of its records to determine the best way to give taxpayers the additional credits they may be due.

In the information document matching program, the IRS compares the returns taxpayers send to the IRS with information received from third parties, such as Forms W-2 reporting wages and Forms 1099 reporting income such as interest, dividends and lump sum pension distributions. The matching program for tax year 1985 is complete and the program for 1986 is in progress. Matching for 1987 returns will begin later this year with the revised procedures in place.

(MORE)

In the 1985 matching program, 8.7 million returns were selected because of apparent discrepancies. The IRS needed to contact 4 million of these taxpayers to resolve the apparent discrepancies.

Here's how the matching program works. Initial comparison of the tax returns and the information documents is done by computer to identify differences. IRS examiners then look at the actual tax returns to resolve the discrepancies which may result because the income has been reported but on the wrong part of the return or may not be identified accurately. Frequently more than one information document is involved in the apparent discrepancy with the tax return. Discrepancies which cannot be resolved by inspecting the return require correspondence with the taxpayer.

The majority of Federal income tax withholding is reported to taxpayers and to the IRS on Forms W-2 or W-2P. However tax withholding may sometimes also be reported on Forms 1099 information documents, such as the Form 1099R which reports lump sum distributions from pension plans and the tax withheld on those distributions.

The IRS said it is more likely taxpayers could overlook tax withholding on Form 1099 than on Forms W-2 or W-2P. However, only 5 percent of the information documents showing withholding are Forms 1099.

The IRS confirmed after its review that the instructions for the matching program required that discrepancies involving

withholding reported on Forms W-2 or W-2P should be adjusted but some discrepancies in withholding reported on From 1099 were not adjusted. Adjustments can, of course, result in additional taxes due as well as refunds. The IRS said that the difference in the instructions was based on initial screening of various types of discrepancies which indicated that taxpayers generally reported tax withholding from Forms 1099 correctly on their returns.

Taxpayers should review their 1985 returns, especially if tax withholding was reported on a Form 1099. If taxpayers find that they have not claimed all their withholding for 1985 they should file a special claim.

To make such a claim, taxpayers may but are not required to use IRS Form 1040X, "Amended U.S. Individual Income Return," or Form 843, "Claim." Just send the IRS a statement explaining that the taxpayer is entitled to additional withholding credits for tax year 1985. At the top of the page, clearly identify the claim by entering the notation "1985 INCOME TAX WITHHOLDING CLAIM". Include copies of the Forms 1099 and other withholding documents to help the IRS substantiate the withholding which was not claimed on the original return. The claims must include the taxpayer's name, address and social security number and be signed and dated. Mail these special claims to the attention of the Problem Resolution Officer at the IRS service center where taxpayers are filing their 1988 returns.

(MORE)

The attached suggested format for the claim may be used by taxpayers to ensure they provide all necessary information.

Taxpayers who think they may not have claimed all their withholding but do not have copies of their 1985 tax records may still file a special claim by April 15, 1989. This will give the additional time necessary for the taxpayer to obtain copies of the Forms 1099 or other documents needed to process the claim for refund.

X X X

1985 Income Tax Withholding Claim

Name:

Address:

Social Security Number:

Withholding on Original Return _____

Correct Withholding _____

Refund Due _____

Taxpayer Signature Date

Mr. FORD. What kind of checks and balances are there in your regional offices, in your major IRS Service Centers?

I have one in my home town in Memphis—an IRS Service Center. What kind of checks and balances in accountability do you hold in these centers and regional offices, as it relates to many of the issues that has been brought before you today by this Oversight Committee?

Mr. MURPHY. Congressman Ford, we have a plan for that. I am going to ask Mr. Brennan to comment on it, but merely just to preface it by mentioning that this is another area of interest as a result of the IRS–GAO joint review to ensure that not only do we report nationally, but that we have programs that go on down through the system.

Mr. BRENNAN. As I believe you know, the centers report to a regional Commissioner, and we do two things in Washington.

One, we sit down with the regional office and the centers before the year begins and work out a plan. We call it a schedule, a work schedule, as to what they are supposed to do during the forthcoming year, and when they are supposed to do it.

That is agreed upon between the national office, the regional office and the service center. This is monitored throughout the year. Some figures on a weekly basis, some on a monthly basis, to make sure that everything is going according to that agreed upon plan.

Secondly, and more broadly, we have what we call a National Office Review Program which will formally go to the regions and review what they are doing to meet their responsibilities, not only in the service center area, but in the entire region.

So broadly, that is the two things that we do.

Mr. FORD. Knowing, Mr. Murphy, that this is a filing season and you are Acting Commissioner of the Internal Revenue Service, are there any plans to confirm you as Commissioner, or are there any plans to name a Commissioner in the immediate future?

Mr. MURPHY. Well, Congressman Ford, after the last couple of weeks, that may be the very last thing that I would want, but I am honored to even have you ask me the question.

I am not aware of any nominations by the President of the United States. Until then, I am honored to be the Acting Commissioner, and I certainly want to cooperate and accept whatever support the chairman and the rest of the subcommittee——

Mr. FORD. We wish you well, and as a member of this Oversight Committee, we certainly want you to know that we have raised some concerns that the American taxpayers have brought to our attention, but at the same time, we want to be supportive of an Acting Commissioner of the Internal Revenue.

Mr. MURPHY. I appreciate that, Congressman Ford.

Mr. FORD. Thank you.

Chairman PICKLE. Thank you, Mr. Ford, and many of us echo your sentiments too.

Now, Mr. Murphy, we are going to ask the General Accounting Office to come forward and present their testimony.

I would hope that you and your two assistants there will wait, because we may want to have you all in the same bullpen together here. So I thank you very much for your testimony.

Mr. MURPHY. Thank you, Mr. Chairman, and thanks for your support. We really appreciate it.

Chairman PICKLE. Now we will hear testimony from the General Accounting Office. I guess it is Jennie Stathis. Is that who it is? I do not have a list.

[Pause.]

Chairman PICKLE. Here it is.

The General Accounting Office will be represented by Jennie Stathis, Director of the General Government Division.

Jennie Stathis will come forward to the witness table.

[Pause.]

Chairman PICKLE. While Ms. Stathis is taking her position at the table, I want to ask also if Mr. James R. Watts, the Associate Director of the Information Management and Technology Division of the General Accounting Office, would also take his position there. We will do both together.

Now, Ms. Stathis, if you will proceed with your testimony. We are glad to have you here this morning.

STATEMENT OF JENNIE S. STATHIS, DIRECTOR, TAX POLICY AND ADMINISTRATION ISSUES, U.S. GENERAL ACCOUNTING OFFICE

Ms. STATHIS. Good morning, Mr. Chairman. We are pleased to be here this morning. I will, as Mr. Murphy did, try to summarize by walking through the statement.

We do have five points this morning. The first one deals with the accuracy of IRS answers to tax law questions, the second one deals with forms and publications, the third one deals with returns processing this year, the fourth point talks about the percentage of returns that may have errors this year, and the fifth one deals with the inventories in the service centers.

At your request, we did our own test of the accuracy and the availability of IRS telephone assistance this year. Between February 21 and March 3, we made 922 test calls to 29 IRS call sites.

This year, taxpayers may experience more difficulty telephoning the IRS because, during our test, we reached an assistor on the first attempt 69 percent of the time, compared to 76 percent of the time last year. So there was a small decline in our ability to reach an assistor.

How accurately IRS answers taxpayers depends upon the questions they ask. For our test, we used 22 test questions and for the answers that we received, we got correct responses 66 percent of the time. The other 34 percent were answered incorrectly.

The comparative figures from our test last year were 64 percent correct and 36 percent incorrect, so as you can see, our test would show that the accuracy rate is pretty similar this year to what it was last year.

Chairman PICKLE. Your rate compares how to the IRS rate?

Ms. STATHIS. Our rate falls pretty much in the middle of the two rates IRS gave you this morning, but ours is based upon the standards for their lower rate. It would compare to their 62 percent. We are showing 66. They are showing 62 using the same standard.

Chairman PICKLE. Did you use a different set of questions than the IRS used?

Ms. STATHIS. It is a smaller number. We used 22 questions out of the 62 that IRS is using. So they are the same questions as IRS is using, but not all of the ones that IRS is using.

Chairman PICKLE. How much, I mean, 22 out of 64?

Ms. STATHIS. Twenty-two out of 62—about a third.

Chairman PICKLE. About a third? Why would you use, then, only one-third so there is two-thirds difference in the questions?

Ms. STATHIS. It concerns how many test calls you are going to make.

As you know we have made this test calling now for about a decade at your request and that of another subcommittee. We always aim for just one statistic that would reflect accuracy around the country as a whole.

To do that, you do not need to make as many test calls as you do if you want to compare each of your call sites. Therefore, IRS, which for management purposes, wants to know how one call site is doing in comparison with another one, would need to make more calls than we do.

In doing that, they are afraid if they ask the same few number of questions that many times, the assistors would get tipped off that these are test call questions.

Chairman PICKLE. Did you complain to the Internal Revenue Service that there was this significant or mark difference in the set of questions?

Ms. STATHIS. I do not think that that is a correct way of looking at it. In fact, I do not think either one of us has any concern about the number of questions that we are each using.

Chairman PICKLE. Well, I understand that there was a great cry from the General Accounting Office that you were conducting the test using one set of questions, and that the IRS was using another set of questions. Is that incorrect?

Ms. STATHIS. The issue centers around determining what is a correct answer. As Mr. Murphy testified this morning, using the standards that our two agencies agreed to, he would have correct answers 62 percent of the time.

The issue is another 8 percent of IRS calls that IRS believes are not incorrect and that they have added to the 62 percent to show a 70 percent, or thereabouts, accuracy rate.

The issue is that 8 percent. Are they correct or are they not? We do not believe they are.

Chairman PICKLE. All right. Well, the issue, then, is in that area of that 8 percent approximate figure.

Ms. STATHIS. And it has to do with scoring answers, not with the questions that are being asked.

Chairman PICKLE. Well, we would assume that if GAO is asked to conduct a survey, that you are going to ask the questions in cooperation with the Internal Revenue Service in this particular case, and that you ought to be asking the same questions. Is there any variance you can see why you would have different results and a different set of figures, and we do have a different set of figures.

Now, if it is only 8 percent, I do not know if that is critical, and I do not know whose nose ought to be out of joint because of that. I understand that you did object strongly to some of the people here on the Hill.

To the extent that there ought to be the same questions at the two agencies, it seems to me that it is really immaterial in some sense of the word. As I said earlier, GAO said IRS gives approximately 40 percent, 37.6 percent, incorrect answers. IRS said, "No, only 30 percent." That is saying that we give them a "D" or a "D minus".

It is just bad either way you look at it. I would expect full cooperation of the two agencies in conducting any kind of survey. If you have concerns or objections or criticism about the approach that one agency takes as against another, I would want to know that, and you should report that to the Congress.

Ms. STATHIS. Mr. Chairman, just to correct the record, we did not know that IRS was going to use that particular statistic on that basis until it was reported in a press conference last week.

Having learned that that statistic was used, we made our protest to IRS.

Chairman PICKLE. You made your protest to whom?

Ms. STATHIS. We made our protest to the Director of the Taxpayer Services Division at IRS. The particular people we were dealing with——

Chairman PICKLE. What person? Who was that?

Ms. STATHIS. That is Mr. Labaube.

We did not call anyone on the Hill to protest, because we felt that this was between our two agencies, and only when we received a phone call asking what we thought about the statistics, did we offer any answer to anyone.

Chairman PICKLE. Well, I think the press conference held by the IRS was rather a surprise to many of us, but the fact is that it was made.

But, we get down to the basic question, how much difference is there? The two agencies sound kind of like squabbling between kids in a food fight of some kind, and that is just not acceptable—

Ms. STATHIS. And I think our perspective is the same as yours, Mr. Chairman, which is that there is not a lot of difference.

Whether you have a "D minus" or a "D plus", it is a pretty poor performance.

Chairman PICKLE. Yeah, but you did not complain to our committee or to anyone on the Hill that you thought this was a significant difference, did you object to their release?

Ms. STATHIS. That is correct.

Chairman PICKLE. But otherwise you did not make an issue of it at that point.

All right. Go ahead. I am sorry for that interruption.

Ms. STATHIS. OK. Let me clarify too that the difference, you know, that we were talking about, is the difference between IRS' two numbers, not the difference between our two tests. As far as I know, IRS has no complaints about the tests we made particularly for you.

Moving on, then. Of the 22 questions we used, 11 of them were the same questions we used in our test for you last year. We like to have questions that can be carried over from year-to-year, because you can have a direct comparison then of the results from 1 year to the next.

On those questions, with the exception of one question, we got similar results, which reinforces our view that the accuracy rate is similar to last year.

Why has IRS had these quality problems? As you mentioned, they did not have to hire as many new people this year, so we too would have thought that the rate would have increased.

One reason for the problem may be the fact that in some areas of the country, especially large metropolitan areas, IRS has found it difficult to compete with private industry in hiring employees.

As a result, potential recruits in these areas are not as well qualified as those in other areas, and many of those hired either fail or drop out of the training classes. We have the example here that Mr. Brennan was trying to give you earlier, and this was Los Angeles, where they had a 35 percent drop out in a training class. I understand that San Francisco is in a similar range. These high turnover rates increase IRS training costs, and they make it more difficult to hire and train replacements for the filing season.

The quality of training IRS provides can also affect the quality of its answers, and for that reason, we have just begun to look at training. Early indications are that the course materials may need to be improved.

Moving to forms and publications—as you mentioned in your opening statement, last year we reported to you on some problems in the availability of forms, and for that reason you asked us this year to monitor their availability again.

We thought you would want to know that IRS made several changes this year to try to improve the availability of these forms. They came up with a list of 79 items that were to be stocked in all of the walk-in sites, and they developed a training course to try to help prepare their people.

In late January and February, we checked on the availability of those forms at 35 walk-in sites. None of them had all 79 of those items. Fifteen of the sites had ten or more items missing, ranging all the up to one site that had 41 missing items.

Our statement includes a list of some of the types of forms and publications that were missing.

There were several reasons why materials were unavailable. The site's supply had run out in some cases and replenishments had not been ordered or replenishments had been ordered but not yet received. I think the largest number of cases, Mr. Chairman, involved instances where the site had not received its initial supply of the document, even though it was late in January and early February.

Another reason was that the site had not intended to stock the missing document, even though it was on the required list. My understanding is that there was some timing difference here between when the 79 item list was prepared and when the sites decided what they were going to stock.

Another reason, we found, for continuing problems could have been the fact that a lot of the employees at the sites we visited had not yet had the inventory management training IRS had developed, even though it was well into the filing season.

We are revisiting some of those sites, and as we revisit them, we are finding that the availability of forms and publications is improving.

We also looked at mail and phone orders. In order to evaluate the ordering system, we placed random mail and phone orders in late January and February.

As you mentioned earlier, each of our orders was for 10 items selected randomly from the most recent list of available forms and publications, and each of the 39 orders we had received as of March 3, were received within the 10 day period, the standard that IRS uses. But only four of the orders contained all 10 items. The other 35 orders lacked from one to four of the items.

We would not expect all of our orders to come in complete, Mr. Chairman. We would have expected some of them to have missing items.

I think the important point for us was that so many of them did not tell us any status on the missing items. IRS procedures would call for the order form to show us that they had been back-ordered, but they did not tell us that in many cases. I think it was 42 items, involving 21 of our orders where we had no explanation as to why we did not have a document.

I will add, parenthetically, that we are now beginning to receive some of the missing documents, even though we had not been told they were back ordered. It may be that by the time we would have to file a tax return, we might have received them all. We will continue to pursue both of these areas and let you know how that turns out.

In terms of returns processing, as IRS has already told you, things appear to be proceeding smoothly. There are a few service centers that are falling behind last year's pace, but IRS does not believe this will be a problem. If things continue as scheduled, we should be able to make it through the filing season well.

Moving to taxpayer errors, it is good that taxpayers and IRS are making fewer errors this year. The percentages we show in our statement are 15.8 percent compared to 18 percent last year.

IRS statistics would show that taxpayers made about 59 percent of those errors by doing such things as forgetting to check a box or failing to enter a piece of information, or making a math error.

The other errors in that statistic are IRS' processing errors, where they may have made a code or edit mistake, for example.

As for service center inventories, most are running below last year's levels. So they are really not of that much concern. One exception we mention in our statement is the "entity" inventory. That inventory includes cases for which IRS needs to update or correct taxpayer files because of such things as name or address changes. The entity inventory is about 22 percent higher than last year, but IRS officials continue to believe that that is within manageable levels.

So in conclusion, although IRS has not experienced any unusual delays in processing returns, some service centers appear to be falling behind in processing their workloads.

Also, a large percentage of the answers to test questions were inaccurate, forms and publications were not as available as they should have been during the first part of the filing season, and taxpayers have been making some of the same errors they made last year, even in situations where IRS took steps to try and clarify the requirements.

That concludes my prepared statement.
[The statement of Jennie S. Stathis follows:]

Statement of Jennie S. Stathis, Director, Tax Policy and Administration Issues, U.S. General Accounting Office

We are pleased to be here today to assist the Subcommittee in its inquiry into the status of the 1989 tax return filing season. My testimony makes five points:

-- First, IRS still needs to improve the accuracy of its answers to tax law questions. Our test shows an accuracy rate of 66 percent.

-- Second, taxpayers may be having difficulty obtaining the tax forms and publications they need.

-- Third, IRS appears to be processing returns smoothly and more taxpayers are filing simpler tax forms. Some service centers, however, have fallen behind last year's processing pace which could cause problems later.

-- Fourth, the percentage of filed returns that contain taxpayer errors or that IRS erroneously processed is lower than last year, but taxpayers are still making many of the same kinds of errors as they did last year.

-- Fifth, of the various service center inventories, one that appears to have increased substantially compared to last year is the inventory of cases that require IRS to update taxpayer files because of such things as name changes and changes to accounting periods.

TELEPHONE ASSISTANCE

At your request, we tested the accuracy and availability of IRS' telephone assistance. Between February 21 and March 3, 1989, we made 922 test calls to 29 IRS call sites.

This year, taxpayers may experience more difficulty telephoning IRS. During our 2-week test, we reached an assistor on the first attempt 69 percent of the time compared to 76 percent last filing season. The rate increased to 92 percent within five attempts, which was about the same as last year's rate.

How accurately IRS answers taxpayers will depend on the questions they ask. For our 22 test questions answered in 824 calls, we received correct responses 66 percent of the time. The other 34 percent were answered incorrectly. Last year, using 20 test questions, we had 64 percent answered correctly and 36 percent incorrectly. This year, we also computed an accuracy rate that reflects how often taxpayers ask questions similar to those in our test. Using this weighting, the accuracy rate declined slightly to 65 percent.

Eleven of this year's 22 questions were also in our test last year allowing a more direct comparison of results between the 2 years. The accuracy of assistors' answers to these questions declined--from 72 percent last year to 64 percent this year. The difference was primarily caused by one question on the earned income credit. For 10 of the 11 questions, the accuracy of assistors' answers appears to be about the same this year as last.

Although it has improved, probing by assistors continues to be a problem. Assistors need to determine enough about a taxpayer's situation to provide correct responses. This year, assistors had the greatest difficulty responding to questions about the earned income credit, deductions for individual retirement arrangements, and miscellaneous deductions on Schedule A.

Why has IRS had quality problems in this aspect of taxpayer service, especially given that IRS did not have to hire as many

new assistors as last year? IRS converted to full-time status many assistors who were temporary hires last year. Thus, these assistors have received additional training and are more experienced than they were a year ago.

One reason for the quality problems may be the fact that in some areas of the country, especially large metropolitan areas, IRS has found it difficult to compete with private industry in hiring employees. As a result, potential recruits in these areas are not as well qualified as those in other areas; and many of those hired either fail or drop out of training classes. In Los Angeles, for example, 35 percent of those hired for a February 1989 training class dropped out or failed the course. High turnover rates increase IRS' training costs and make it more difficult to hire and adequately train replacements for the filing season.

The quality of training IRS provides its assistors can also affect the quality of their answers. We have just begun to review that training. Early indications are that the course materials may need to be improved.

As you know Mr. Chairman, we are also monitoring the test calls IRS is making to measure the accuracy of assistors' answers to individual tax law questions. During the past year, we have worked with IRS to develop its testing system. A major part of our effort has been spent in developing a set of 62 questions and reaching agreement with IRS on the answers that would warrant a correct score for each question. Last week, IRS released statistics on the accuracy of answers for 29 of the 62 test questions based on more liberal scoring of responses to certain questions than we had agreed on. Using the agreed on scoring for the same time period and the same set of questions would show that assistors correctly responded 60.4 percent of the time rather than the 69.2 percent figure IRS reported. For several reasons, we do not think IRS should revise its scoring after having gone this far into the test period.

AVAILABILITY OF FORMS AND PUBLICATIONS

This year and last, IRS engaged in a media campaign designed to encourage early filing. To file early, taxpayers need the necessary forms and publications. Last year, we reported to the Subcommittee that some forms and publications were not available during the first part of the filing season although the situation improved as the filing season progressed.

IRS made several changes this year in an attempt to improve the availability of tax materials. For example, IRS established a list of 79 forms and publications that each walk-in distribution site is to stock and developed a course on inventory management for personnel at those sites. Despite these efforts, tax materials have not been more readily available than last year.

In late January and February, we checked on the availability of the 79 forms and publications at 35 walk-in sites in 10 states. None of the sites had all 79 items. Fifteen of the sites had 10 or more items missing; one of those sites did not have 41 items. Among the items missing at several sites were Form 2210, which is used to report underpayments of estimated tax, and publications dealing with charitable contributions, individual retirement arrangements, business and moving expenses, tax rules for children and dependents, and supplemental medicare premiums.

According to IRS personnel at the walk-in sites, materials were unavailable either because (1) the site's supply had run out and replenishments had not been ordered, (2) replenishments had been ordered but not yet received, (3) the site had not received its initial supply of the document, or (4) the site had never

intended to stock the document even though it was on the list of required items.

Another reason for continuing problems with the availability of tax materials may be the fact that several employees had not taken the inventory management training even though the filing season was well underway. IRS developed this course for personnel responsible for ordering and distributing tax materials at the walk-in sites. Of the 35 people primarily responsible for inventory management at the sites we visited, 19 had received the training by the time of our visit and 16 had not. Even where training had been received, however, inventory management procedures were not always being followed. At several such sites, for example, stocks of one or more of the forms and publications were at or below their reorder points but no additional supplies had been ordered.
We will revisit some of the walk-in sites several times during the filing season to see if the availability of materials changes. As of March 3, 1989, we had visited 10 of the 35 sites a second time and found that the number of available forms and publications had increased substantially since our first visit.

Taxpayers can also order tax materials by mail or phone from one of three IRS distribution centers. In order to evaluate that ordering system, we placed random mail and phone orders in late January and February. If our results are any indication, taxpayers may be having trouble getting what they order from the distribution centers.

Each of our orders was for 10 items selected randomly from IRS' most recent list of available forms and publications. Each of the 39 orders we had received as of March 3 was received within 10 days, which is IRS' goal for filling mail and phone orders. Only 4 of our orders, however, contained all 10 items we ordered. The other 35 orders lacked from 1 to 4 of the 10 items. According to IRS officials responsible for the forms distribution program, if an ordered item is out of stock, the distribution center is supposed to back order the item and let the taxpayer know. Of the 70 items missing from the 39 orders we received, we were advised by the distribution center that 26 had been back ordered and 2 were obsolete. The other 42 items, involving 21 orders, were missing with no explanation as to why and no indication that they had been back ordered.

We will pursue the reasons for both the walk-in and mail-order problems as we continue our review for the Subcommittee.

RETURNS PROCESSING

Although IRS appears to be processing tax returns smoothly this year, some service centers have fallen behind last year's processing pace. If that trend continues, it could cause processing problems later on.

As of March 10, 1989, according to IRS' statistics, 2.2 percent more individual income tax returns had been received than were received as of that time last year. The statistics indicate, however, that some service centers have fallen behind in processing those returns. When compared to the amount of returns they were scheduled to have processed by March 10, for example, Brookhaven and Kansas City were 11.4 percent and 10.2 percent behind schedule respectively even though they had received more returns than scheduled. IRS' Assistant Commissioner for Returns Processing told us that he viewed this as a temporary situation and did not anticipate any major problems.

None of the three service centers we contacted had experienced any unusual problems that impaired their ability to process returns this year, and each appeared sufficiently staffed for the function. If the processing workload at any of IRS' centers

begins to cause problems, we would expect IRS to do what it has done in the past--divert resources from other service center functions. Although the diversion of resources would ensure sufficient processing staff, it would create the challenge of adequately training staff in a short time to process the workload accurately.

One encouraging sign in the statistics for this filing season is that a greater proportion of taxpayers are filing the simpler tax forms (1040A and 1040EZ) than did so last year. Although it was expected that passage of the 1986 Tax Reform Act would result in more Americans filing simpler returns last year, many taxpayers actually filed more difficult forms last year than their circumstances warranted.

IRS AND TAXPAYER ERRORS ON FILED TAX RETURNS

Taxpayers and IRS are making fewer errors this year. IRS' statistics as of March 8, 1989, show that the percentage of returns that taxpayers erroneously prepared or that IRS erred in processing was down to 15.8 percent compared to last year's 18.0 percent.

According to IRS, taxpayers made most of the errors (about 59 percent) by doing such things as forgetting to check a box, failing to enter a required piece of information, or making a mathematical error. IRS' analysis indicates that taxpayers are making many of the same types of errors as last year, even though IRS attempted to avoid some of those errors by changing the related forms or instructions. The most prevalent errors identified by IRS involved taxpayers (1) failing to enter a standard deduction or entering an incorrect standard deduction on Form 1040A, (2) erroneously claiming or computing the earned income credit, (3) figuring the refund amounts on Forms 1040EZ and 1040A incorrectly, and (4) failing to check a box on line 4 of the 1040EZ to indicate whether they can be claimed as a dependent on another person's return.

Among the changes IRS made to this year's forms and instructions in an attempt to avoid some of the errors taxpayers made last year was the addition of a note on the Form 1040EZ reminding taxpayers to check one of the boxes on line 4. IRS also printed the boxes in bold type to attract the taxpayer's attention. Although it is too soon to tell whether those changes will serve to reduce the total number of errors involving line 4, the early returns indicate that it is still a problem area.

IRS attributes most of the other errors on filed returns to mistakes made by service center staff responsible for processing tax returns. Those errors include staff failing to properly code and edit information on tax returns before entering the information for computer processing. Some of the items being improperly edited concern dependents, filing status, and withholding.

SERVICE CENTER INVENTORY LEVELS

Inventory levels at IRS' 10 service centers can fluctuate significantly from one week to the next making it difficult to provide an overall assessment of their manageability. Our analysis of the various inventory levels indicates, however, that most are running at or below last year's levels. One exception is the inventory of cases that require IRS to update or correct taxpayer files because of name changes, address changes, changes to accounting periods, or requests for employer identification numbers. Although this inventory has increased by about 22 percent since last year, IRS officials said the inventory is still within manageable limits. They cited various

reasons for this year's increase including (1) a broader definition of cases included in the inventory and (2) a build up of cases involving taxpayer requests to change accounting periods as a result of the Tax Reform Act of 1986.

In discussing service center inventories, size is just one consideration; quality is another. In a report issued last year, for example, we noted that 31 percent of the cases closed out of the correspondence inventories in three service centers between May 4 and July 31, 1987, contained critical errors. Those errors included incorrect adjustments to taxpayers' accounts and incorrect or unresponsive letters to taxpayers. IRS is taking steps to address the problems we noted. For example, it will be implementing a new system to help service center staff compose more responsive letters and has developed a system for routinely assessing the quality of service center correspondence.

CONCLUSION

In conclusion, although IRS has not experienced any unusual delays in processing returns, some service centers appear to be falling behind in processing their workloads. Also, a large percentage of IRS' answers to test questions were inaccurate, forms and publications were not as available as they should have been during the first part of the filing season, and taxpayers have been making some of the same errors they made last year even in situations where IRS took steps to try and clarify the requirements.

We will continue to monitor telephone assistance, forms distribution, and returns processing during the rest of the filing season and will apprise the Subcommittee of our results.

That concludes my statement Mr. Chairman. We are prepared to answer any questions.

Chairman PICKLE. Ms. Stathis, will you submit to this committee the name of those districts or those stations where you think they are falling behind in processing returns? We would like to have that information from you.

Ms. STATHIS. OK. We have two of them in the statement, Mr. Chairman, Brookhaven and Kansas City. I believe the third one is Fresno.

Chairman PICKLE. Brookhaven, Kansas City and Fresno?

Ms. STATHIS. That is correct.

Chairman PICKLE. All right. Thank you.

Now, Mr. Watts, will you proceed with your statement.

STATEMENT OF JAMES R. WATTS, ASSOCIATE DIRECTOR, INFORMATION MANAGEMENT AND TECHNOLOGY DIVISION, U.S. GENERAL ACCOUNTING OFFICE

Mr. WATTS. Mr. Chairman and members of the subcommittee, we are pleased to be here today to talk to you about the use of computer systems at the Internal Revenue Service. Accompanying me today on my right is Mary Ellen Chervenic, Assistant Director in charge of our computer systems work at IRS, and Richard Clough, Assignment Manager.

I will focus my comments on the development of the Internal Revenue Service's electronic filing system and its progress in installing the front-end processors.

On the basis of our ongoing work on the electronic filing system, we find it is still experiencing some of the same problems that troubled it last year. In our opinion, IRS needs to more clearly define the requirements for the nationwide system that it plans to put in, and determine whether its present approach is the best alternative available.

IRS began developing the electronic filing system in 1986 to meet its long-range needs for a nationwide system. It expected to field the system in 1988, however, it was forced to abandon this approach for the system in November when Treasury disapproved its strategy for acquiring the computers for the system under an already existing contract that was awarded for a different purpose. Treasury disapproved this strategy not only because purchasing the computers for electronic filing was beyond the scope of the contract, but also because the existing contract was in danger of going into default.

Because this strategy was disapproved, IRS estimated that it would take until 1990 to begin to field a nationwide system.

IRS chose to press forward with an interim system in 1988 and 1989 until a nationwide system could be developed. It did so knowing that it would result in having to replace software designed to handle only the returns expected for those 2 years. The software eventually cost about $2 million.

The IRS was also aware that the prime contractor believed the interim system ran a high risk of failure during the 1988 season, because the schedule for developing the system left far too little time to adequately design and test it.

Despite these facts, the IRS pressed ahead and expanded the electronic filing system to 16 of its 63 districts.

The interim system was not completely successful during the 1988 filing season. While the system was able to receive and process over 580,000 electronic returns, a major subsystem to correct errors did not operate properly. As a result, stop-gap manual operations were necessary to correct errors in the returns.

The defective software which cost about $2 million is being replaced by other software also costing about $2 million.

Even though a major component of the 1988 interim system was flawed, IRS significantly expanded the use of electronic filing for the 1989 filing season from 16 to 48 of its districts across the country.

At the start of the 1989 filing season, the $2 million replacement system was not ready at the time the filing season began. As a result, IRS had to print paper copies of thousands of the electronic returns that contained errors so they could be corrected and refunds processed.

In mid-February, IRS decided to install only those portions of the system that were essential for processing the returns, thereby avoiding the need to continue printing out copies of the returns.

However, the replacement software will not be complete or fully tested until about mid-April, after the end of the filing season.

An unresolved issue is a need for paperwork to accompany the electronic returns. For each electronic return, the tax preparer must mail IRS a form with the taxpayer's signature and copies of the W-2s. Service center staff then review the forms to ensure that they have a signature and the W-2s for each electronic return.

Service center officials told us this is becoming a task of major proportions. IRS is currently employing 47 people to receive, review and file these forms. This does not include the additional staff who transcribe the information from these forms into the computer.

After the 1988 filing season, the electronic filing project office abandoned its plans to develop a new nationwide system and instead is proposing to invest about $20 millon to expand and modify the interim system. To date, however, IRS has not demonstrated through either analysis or experience that the interim system will be able to meet its long-range needs. Before committing to this approach, IRS needs to clearly spell out its needs, and evaluate the costs and the benefits and technical feasibility of alternative approaches.

Factors that need yet to be addressed include assessing whether the current system will meet nationwide needs, since the current system was not designed or justified on the basis of satisfying those needs. Second they need to decide how to minimize the paper work that does presently exist in the current electronic filing system. And finally, they need to decide how the current system will accommodate the processing of tax due returns, presently planned for next year.

Now all of these factors can have a significant impact on the system requirements for the system and how it will be designed. We discussed the need for the IRS to define its requirements and better assess those alternatives with Treasury officials, and they have decided and directed IRS to perform the necessary analysis, which IRS has agreed to do.

In concluding my summary statements I would like to comment briefly on the front-end processors. As you know the project has encountered several delays over the years. However, the system has now been installed in all 10 service centers, and appears to be working reasonably well. Although the system is in operation at this time, the contractor has yet to deliver acceptable systems documentation, and correct some software problems that do not affect the processing returns.

Until the contractor completes these actions, IRS is withholding payments due the contractor which had accumulated to about $4.5 million at the end of last month. We believe IRS is acting prudently in withholding these payments until performance is complete.

Mr. Chairman, that concludes my summary of my statement; I would be happy to answer questions.

[The statement of James R. Watts follows:]

STATEMENT OF JAMES R. WATTS, ASSOCIATE DIRECTOR, INFORMATION MANAGEMENT AND TECHNOLOGY DIVISION, U.S. ACCOUNTING OFFICE

Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to discuss IRS' acquisition and use of computer systems. I will focus my comments on the development of IRS' electronic filing system and the agency's progress in installing new communications processors. On the basis of our ongoing work in these areas, we found that:

-- The electronic filing system is still experiencing some of the same problems that troubled it during the 1988 season. IRS needs to clearly specify the requirements for the nationwide system and determine whether its proposed approach is the best available alternative.

-- The communications processors were fully installed as of December 1988 and are working reasonably well.

My testimony is based largely on work that is still in process. As a result, these observations are preliminary.

ELECTRONIC FILING

Through IRS' electronic filing system, individual tax returns can now be filed using computers instead of the traditional paper returns. The agency expects that electronically filed returns will be less costly to process and store than paper returns, and that the system will enable IRS to provide faster refunds to individuals. However, we are not aware of any approved studies that quantify these benefits. On the basis of its limited experience with electronic filing over the last 3 years, IRS projects that of the approximately 110 million returns anticipated in 1989, about 2.2 million returns will be filed electronically. By 1997, the agency projects that over 36 million of an anticipated total of 123 million returns will be filed electronically. Through fiscal year 1988, IRS had spent about $13 million developing and operating an electronic filing system and plans to spend another $163 million on development and operations through 1999.

IRS developed a pilot system in 1986 to test the technical feasibility and public acceptance of electronic filing. The goal was to test the system in a small geographical area and, if the test was successful, expand the availability of electronic filing to increasingly large numbers of taxpayers. On the basis of the preliminary results of this test, IRS began developing an electronic filing system in 1986 that would serve as the basis for meeting the agency's long-range needs for nationwide electronic filing. IRS expected to field the new system in 1988. A key part of its strategy was the acquisition of mainframe computers that would be used for processing the electronic returns.

IRS was forced to abandon its development approach for the nationwide system in November 1986 when its strategy for acquiring the necessary mainframe computers was disapproved by the Department of the Treasury. The acquisition strategy involved using an existing contract to purchase the computers, i.e., the Communications Replacement System contract. Treasury disapproved this strategy for two reasons: (1) the existing contract was in danger of going into default, and (2) purchasing computers for electronic filing was beyond the scope of the existing contract. While we were told that no documentation for this decision exists, both Treasury and IRS officials substantiated this information. Because the strategy was disapproved, IRS estimated that it would

take until 1990 to compete a new contract and begin fielding a nationwide system.

According to the Assistant Commissioner for Information Systems Development, IRS chose to press forward with an interim system for use in the 1988 and 1989 seasons because it wished to extend the benefits of electronic filing as soon as possible. IRS chose this interim approach knowing that it would result in having to replace software that was not designed to handle the much larger volume of returns expected when electronic filing is expanded nationwide. This software cost about $2 million. IRS was also aware that the prime contractor believed the system ran a high risk of failure during the 1988 tax season because its development schedule left too little time to adequately design and test the system. Despite these facts, the agency decided to accept the risks of pressing ahead and, in 1988, expanded the availability of electronic filing from 7 metropolitan areas to 16 IRS districts.

The interim system was not completely successful during the 1988 filing season. While the system was able to receive over 580,000 electronic returns, a subsystem used to correct errors did not operate properly. Specifically, an electronic replica or image of the returns could not be properly stored and retrieved as fast and reliably as needed for processing because of defective software. As a result, stop-gap manual operations were necessary to correct errors in returns. IRS tax examiners had to print out paper copies of returns, make written notations of the corrections they made, and store these paper records until the defective software was fixed. This also required all electronic returns--those without errors as well as those with errors--to be reprocessed in 1989 so they could be properly stored and retrieved electronically.

At the end of the 1988 season, IRS decided to replace the defective software prior to the 1989 season because the agency believed the software's design was not usable. The defective software, which cost about $2 million to develop, is being replaced with new software costing about $2 million. According to electronic filing project office officials, the agency's failure to clearly define system performance requirements or allow sufficient time to determine the acceptability of contract deliverables contributed to IRS' inability to resolve the problems with the defective software.

Even though a major component of the 1988 interim system was flawed, IRS significantly expanded the use of electronic filing for the 1989 season from 16 to 48 of its 63 districts, including most major metropolitan areas, using a modified version of the interim system. However, service center officials told us that they are not fully satisfied with its performance. For example, at the start of the 1989 filing season, the $2 million replacement system was not ready for use. Because this system was not ready, IRS had to print paper copies of thousands of electronic returns that contained errors so they could be corrected and refunds issued to taxpayers. In mid-February, although the system was still incomplete, IRS decided to install the portions of the system that were needed for processing electronic returns. By using these portions of the system, IRS avoided having to continue printing out copies of all returns having errors. According to service center officials, the replacement software is still not complete nor fully tested and will not be until about mid-April, the end of the filing season.

An unresolved issue that has existed since the program's inception is the need for paperwork to accompany electronic returns. For each electronic return IRS accepts, the originating tax preparer must mail IRS a form with the taxpayer's signature and W-2. Service center staff review the forms to ensure that they have a signature and W-2 for each electronic return. Service center officials told us this is becoming a task of major proportions. IRS is currently employing 47 staff to receive, review, and file these forms, not including the data entry staff who transcribe information from these forms into the computer.

IRS is now facing a critical decision concerning the system it will use to meet the agency's long-range goals for electronic filing. After the 1988 filing season, the electronic filing project office abandoned its earlier plans to develop a new nationwide system and instead proposed investing about $20 million to expand and modify the current system.

To date, however, IRS has not demonstrated through either analysis or experience that the interim system will be able to meet its long-range needs. Before committing to using a modified version of the interim system for nationwide electronic filing, IRS needs to clearly spell out its needs and evaluate the costs and benefits and technical feasibility of alternative approaches. Factors that need to be addressed include:

-- Assessing whether the current system will meet nationwide needs, since the current system was not justified on the basis of an analysis of such needs. It was originally developed solely as an interim system until a nationwide system could be developed.

-- Deciding how to minimize the burgeoning, paper-intensive nature of the current system. Transmitting signatures and W-2s electronically could significantly affect system design and costs.

-- Deciding how the current system will accommodate the processing of tax due returns, presently planned for 1990. Since the current system is designed to handle refund returns, it will have to be modified to handle tax payments through electronic transfers, credit cards, or other means.

We discussed the need for IRS to define requirements and assess alternatives with officials of the Department of the Treasury, and they agreed with our position. In January 1989, Treasury directed IRS to perform the analysis necessary to identify the best approach. Project officials have stated that this analysis should be provided to Treasury by the end of March 1989.

COMMUNICATIONS REPLACEMENT SYSTEM

In February 1986, IRS awarded a contract to replace its existing data communication processing system and obsolete computer terminals with the new $156 million Communications Replacement System. The system consists of computer terminals, software, and communication processors. The latter are computers through which IRS employees, using the computer terminals, access information from other larger computers to correct errors in tax returns and answer taxpayer inquiries.

IRS initiated the project in 1983 to replace its old processors, which had begun to experience periods of downtime and were operating at or near the limit of their capacity. The project encountered several delays caused primarily by (1) the need to re-award the contract after an original award was overturned as a result of bid protests, and (2) the need to redirect the contractor's efforts after it had failed to produce a workable system in the time required by the contract. By November 1987, the contractor had delivered a system that met most testing requirements. IRS decided to install this system because it believed the unmet requirements would not adversely affect the processing of taxpayer data. On the basis of the success of its initial installations at the Fresno and Austin centers, IRS decided to install the system nationwide. The system is now operational in all 10 service centers and is working reasonably well.

Although the system is operational, the contractor has yet to (1) deliver acceptable systems documentation, and (2) correct some software problems that do not affect the processing of returns. IRS is negotiating with the contractor to establish a schedule for completing these requirements. Until the contractor completes these actions, IRS is withholding payments due the contractor for software development and documentation and for the computer equipment and software installed at IRS' Martinsburg Computing Center. As of the end of February 1989, these withheld payments had accumulated to $4.5 million. We believe IRS is acting prudently in withholding these payments.

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This concludes my prepared statement. I will be pleased to respond to any questions.

Chairman PICKLE. Thank you, Mr. Watts.

Mr. Watts, earlier the Internal Revenue admitted that they had some problem in the electronic filing area, particularly in the area of software that had to be replaced, but that had been replaced and this problem has been solved. Do you agree with that?

Mr. WATTS. I do not really. Today's software is still undergoing acceptance testing. Parts of the software are working, but only those that are essential to process the returns and issue refunds. There are certain applications that have yet to be finished and complete testing, and that is not expected to be done until the middle of April.

Chairman PICKLE. Has the software replacement done away with the necessity of converting a lot of these electronic returns to paper before IRS can check them out?

Mr. WATTS. Initially, it did not because it was not ready to process at the time.

Chairman PICKLE. Is it now?

Mr. WATTS. It does now; IRS does not have to print out paper copies of those returns today. They did have to up through mid-February.

Chairman PICKLE. Did you say that verifying the signature on the W-2, or in some way verifying the signature, is becoming a bigger and bigger problem?

Mr. WATTS. It is a problem in a sense that there is a lot of manual effort to look at them. They come into the service centers in batches of paper forms with the signatures and the W-2's. Clerks have to look at those signatures to make sure they are alright if there are matching W-2's. Then they have to turn them over to people to key in that information into the computer system. Presently, IRS is using about 47 people in the service to handle that manual process.

Chairman PICKLE. Did I understand you to say that the present system they were using, the electronic system of hardware and software combined, really was not the proper approach and they ought to abandon it and start a new one? But the IRS decided to go ahead and modify or update the present system and they have invested $20 million additional? Will that solve the problem now, or do we have a serious problem in this area?

Mr. WATTS. As I pointed out in my statement, there are a number of unresolved questions that will affect the design of the system. I am not convinced that the current design is the one IRS should go forward with until it answers those questions. Only then will IRS be able to tell you whether it is going to be $20 million or some other number.

Chairman PICKLE. All right.

Now, Ms. Stathis, the Internal Revenue Service and you have testified that the returns are coming in in a little larger number this year, as compared to last year, and that is encouraging, but the facts also show that they are being processed more slowly. What is your explanation of why that is the case?

Ms. STATHIS. I do not know that we really have an explanation for that. Let me introduce to my left, this is Dave Attianese, our Assistant Director, who is in charge of the returns processing work,

and to his left Larry Endy, who has been responsible for our taxpayer service work.

Chairman PICKLE. All right.

Mr. ATTIANESE. We do not have any reasons as to why they are falling behind, nor do we really know whether the falling behind is at this point a real problem. We just know that they are starting to fall behind. It may be because they did not have enough staff at that particular time.

Chairman PICKLE. Neither one of you have much of an opinion on whether they are processing more slowly or not, then. I assume that would be your answer.

Ms. STATHIS. Yes.

Chairman PICKLE. All right. Now, you have made quite a report to the other committee and to the public that the Internal Revenue Service is operating on very limited funds and they could not give service. Do you think the IRS is running out of funds?

Ms. STATHIS. Let me make the record clear on that as well. The only part of the article that was in the Washington Post this morning on which the General Accounting Office has testified was one small paragraph on the second page. We have not said anything anywhere about the 1989 budget shortfall, so I do not have on record to give you anything about that. I have no idea where the reporter's information came from. It did not come from us.

I am aware that there is a budget shortfall. It is our understanding that the returns processing and taxpayer service functions are being fully funded, and that it is in the area of examination and collection, the enforcement functions that are suffering.

Chairman PICKLE. All right. In the area of the availability of tax forms and various publications, you said that the General Accounting Office had placed 39 mail and phone orders to the IRS form distribution centers, and that each of the orders were received within 10 days, yet only 4 arrived complete.

Now, earlier this morning, Internal Revenue had indicated that there is a problem with "obscure forms," I believe that was his phrase. My question to you, then, was what kind of forms were you ordering. Were you ordering the obscure forms?

Ms. STATHIS. We do not have with us a list of what those forms are. I would be happy to provide them to you for the record. All I can say is that they were from the most recent list of available forms and publications. Some of them may be forms that are not as popular or as frequently asked for as others. I really do not have that information, but we will provide it for the record.

Chairman PICKLE. I want to see that, because if the lack of forms is in an area that is obscure or used seldom, I can understand why they might not have every form that you would order. But, if you are ordering regular forms that would normally be used by any and all of the citizens, then of course we would expect IRS to have those forms. I would like to make an analysis, so I would ask you to submit that information to us.

Ms. STATHIS. OK. We will do that. I would like to say that the statistics that Mr. Wedick gave you I think are correct, that we have received 340 of 390 items, so if you were to call that an accuracy rate, that would be about 87 percent.

[The following was subsequently received:]

In testing IRS' responsiveness to phone and mail orders for tax forms and publications, we have been periodically submitting orders to each of IRS' three area distribution centers. In deciding which forms and publications to order, we randomly selected items from two IRS lists—one of major tax items and one of minor tax items.

As noted in our testimony, 70 items were missing from the 39 orders we had received as of March 3, 1989. Of those 70 items, 29 were included on IRS' list of major forms which the other 41 were on the list of minor forms. Among the major items missing from our orders were several publications dealing with issues, such as miscellaneous deductions, self-employment tax, employment taxes, highlights of 1988 tax changes, and supplemental medicare premiums, that would be of interest to many taxpayers.

As we testified, however, we are not concerned so much by the fact that an item was missing from our order as we are by the absence of any explanation from the distribution center as to why the item is missing or any indication that it has been back ordered. That kind of information should be provided whether the missing item is considered major or minor.

Mr. ATTIANESE. May I add something to that, Mr. Chairman?

Chairman PICKLE. Yes.

Mr. ATTIANESE. The thing that bothers us most about not receiving the forms is not the fact that we did not receive the forms, because some of the forms are minor forms, but all the forms are supposed to be stocked at the distribution centers. The problem is that when we do not receive the form, we are supposed to get some indication from IRS that they recognize we ordered the form and that they have back-ordered it and will send it to us. We are not getting that in a lot of our orders, and that is the problem we have.

Chairman PICKLE. I understand that. IRS has testified that in many instances they were using voluntary workers. Whether they are volunteers or whether they are regular employees, I can see why they should have some statement in the orders.

You also did add this morning, contrary to your previous testimony submitted, that you are beginning to receive some of those forms later as a follow-through. So there is a an accounting within the distribution center indicating that they did not send you all the forms and, when IRS got them, they did send them. I think we ought to put that into the equation to fully understand.

If we could have an examination of the forms you ordered and what they should have in stock, then we could make an evaluation of that.

At this point, let me ask Mr. Schulze if he has any questions.

Mr. SCHULZE. Just a couple, Mr. Chairman, thank you. I missed a portion of your testimony and perhaps you covered this, but it seems to me that the pattern of receipts is changed somewhat from previous years when we are falling behind. Does that take into account that the pattern is a little bit different?

Ms. STATHIS. The statistics that we are using in the statement are on the basis of the schedule for this year, and the schedule factored in those things. It factored in the idea that Philadelphia was going to have more returns this year, because of changes in workloads, but also accounted for the staffing changes that were to go along with that. So, even with those adjustments, we have three service centers falling behind. Philadelphia is not one of them.

Mr. SCHULZE. When we say "falling behind," I presume that is entering the data which they receive, at that stage?

Ms. STATHIS. That is correct.

Mr. SCHULZE. It is not at a later stage. It is at the beginning stage of the process?

Ms. STATHIS. Well, that is a complete process. In other words, the tax return has been entered into the computer system, a refund given or payment processed.

Mr. SCHULZE. So, it can be at any point in the stage, not necessarily just at the beginning?

Ms. STATHIS. It is the complete processing of returns.

Mr. SCHULZE. All right. Is there any particular area in that process which is causing more trouble?

Mr. ATTIANESE. Not that we know of. We have not done enough analysis to know if there's any particular problem area.

Mr. SCHULZE. So, there is nothing that we can really definitively put a finger on and say this is the area where we must catch up or move up a little bit?

Mr. ATTIANESE. No.

Mr. SCHULZE. As you well know, we had some problems with the front-end processors. If we are going to pursue a greater acquisition, have you made recommendations to make sure we do not make the same mistakes in the modernization program? It seems to me we even had a problem in the way we let the contract for the front-end processors, if my memory serves me correctly. Do you have any suggestions to make, or have you made suggestions so that we do not make those same mistakes again?

Mr. WATTS. Well, I think there are some lessons to be learned from on the front-end processor procurement that could be very useful to IRS. One of the things that they need to do a better job of is evaluating the proposals that they get from vendors.

If you look at what happened on the front-end processor contract, it was their failure to really adequately evaluate those proposals that eventually led to a bid protest, and that lost them several months of time.

I think another lesson can be learned. After IRS awarded the contract, they got into a default situation with a vendor. Now, I think this could be avoided if IRS were to do a better technical analysis of the proposals it gets, the solutions it gets, particularly when a subcontractor is involved, and I can anticipate in the future there would be a lot of subcontracting with prime contractors, and if you look at what happened on electronic filing and what happened on CRS, the subcontractors were the ones that were having problems. So, there is something I think to be learned from doing a better technical evaluation of those proposals, to make sure they really do match and meet IRS needs.

Mr. SCHULZE. Mr. Watts, was that done in-house, and would you recommend that they use a different system or bring in people from the outside, or advisors or consultant, or what would your recommendation be?

Mr. WATTS. As for the first part of your question, it was essentially done in-house, by in-house people. I think that IRS could look at a strategy to better train the people it has, hire some outside experience, and, to the extent necessary get an outside contractor to help evaluate bids. This is a common practice in many other agencies, I think that IRS ought to look at both of those alterna-

tives and not try to do it in-house solely, particularly in the future when itis going to have so many of these procurements.

Mr. SCHULZE. I might just add parenthetically that I believe the committee was relatively tolerant. There were mistakes made and most of us were extremely unhappy with the way that was handled. We would have much greater ire if such a mistake or if such a problem occurred again. I thank you.

Thank you, Mr. Chairman.

Chairman PICKLE. Ms. Stathis, you had reported to our committee earlier, and I think you made mention of it again today, that the Internal Revenue had paid out some $12.6 million in interest to taxpayers who had filed timely. Now, that is about a 53 percent increase from the prior year. Why has the amount of interest paid by the IRS increased so drastically or so dramatically?

Ms. STATHIS. There were two reasons. The first one was that the interest rate had gone up, so that accounted for some portion of the increase. The majority of the increase was due to taxpayer errors in returns that they filed last year. Taxpayers thought they owed money, so they sent in a check or they thought they did not owe money at all.

Those types of returns, IRS sets aside to work on later. They work on the refund returns first, so they can process them within the 45 day interest-free period and thus avoid paying interest. When they got to this stack of returns set aside, because there were no refunds due, they found that taxpayers had made errors and those errors resulted in the taxpayers being owed refunds. Because they were beyond the 45-day period, IRS had to pay interest on those refunds.

So, that is why it is good news this year that they are having fewer errors on taxpayers' returns. We may be able to avoid that situation this year.

Chairman PICKLE. Mr. Watts, you said earlier to me, just a minute ago, that you were concerned about the electronic filing system and they are going ahead with the present system. Also, you commented with regard to the front-end processors, which are in place and are moving forward, and which you think will function reasonably well now.

Now, we have been in a process of trying to get that new equipment installed and functioning properly for a number of years. You said it was 2 years behind schedule. Now, if it has taken the IRS 2 years to get in a relatively small part of the overall operation of the front-end processors and the communications system, what do you think we can expect in the overall system redesign that is supposed to be in place within the next number of years? If that is a test, should we not be alarmed and frightened about what might happen in the overall system redesigned?

Mr. WATTS. Well, I would say that my optimism and confidence is not very high, when I look at the future, based on what happened on the front-end processor. The front-end processor situation was a large effort, it was a $150 million effort, and it was a fairly complex, technical thing to do. But when we look at the modernization, we are talking about orders of magnitude greater in size and, in my opinion, complexity. With that track record, that experience,

I do not have a high degree of confidence that it is going to get done in a 10-year period.

Chairman PICKLE. Well, we will pose this same question to the Internal Revenue Service, because they are the ones that have to answer that more than you. You did point out that this is 2 years behind, although it is in place now. If it took us 6 years or more to get that equipment in line, which is not the major part of the whole tax system redesign effort, then I think we have got to be concerned about what is going to happen.

I want to ask you one more question about electronic filing. Did the Internal Revenue Service put that system in too quickly?

Mr. WATTS. I believe they did, yes. What I have seen in this case and other cases is that the tax filing season itself, January through the end of May, is obviously a very driving force within IRS. IRS tries to time the advent of new systems so they are ready to go in time for a filing system. In both of these cases, both in 1988 and in 1989, when they developed the software, the software was designed and the milestones were set so that it would be fully tested and ready to go by the beginning of the filing seasons. In both cases that did not happen.

Trying to do it within a very short period of time, you end up cutting back on testing and you start putting things into production too early. Now, I think that is the thing that has the tendency to drive them. I am not aware of any particular pressure to make electronic filing a viable thing today, so I am not sure what the pressure is. But, trying to match up against a particular filing season does drive IRS a great deal when it plans to put a system on-line. And when they do not put it on-line, they look at it as missing a year's opportunity.

Chairman PICKLE. All right. Now, we are going to submit to you some additional questions in writing and we would like a response from you as we have also requested from the Internal Revenue Service.

I am going to ask Mr. Murphy, if he is still here, from the Internal Revenue Service, do you want to make any response to any of the statement made by the GAO at this stage before you depart? I am not trying to pit one against the other here in open testimony, but I want to recognize that you have waited, so you come forward once more, if you care to. And Ms. Stathis, if you want to keep your seat, that is all right.

I am not having a trial here, I am just going to give Mr. Murphy a chance to respond to any of the statements or questions that have been made.

Mr. Murphy.

Mr. MURPHY. Thank you for the opportunity, Mr. Chairman. I will be very brief. The only comment that I would make would be to restate what I said to you earlier, that the test call system that we are using in taxpayer service is one that needs continuing nurturing, and I think I certainly would comment again that the cooperation and the teamwork between IRS and GAO is essential to make it work, and we intend to continue that.

The communication issue that Ms. Stathis mentioned and I mentioned is strictly that. Had we to do it over again, we would have put that other number up during the press briefing, and I do not

think we would have had this difference, and we have apologized for that miscommunication.

On the importance of the tax system modernization that I mentioned, and certainly you asked questions about, and what Mr. Watts commented on, I think the points that he made are the types of things that must cause us to keep looking again to make sure that our strategic plans and the plans that we are using, not only to go to the major new processing system, but also the expansion of electronic filing, is one that is a very, very important one and we welcome your oversight on that and would continue to listen to people like Mr. Watts.

I have a little bit of a problem, Mr. Chairman, with the part about what is it, what kind of pressures exist, why would the service want to move quickly on certain items. I came to this hearing this morning prepared to talk to you about and to admit to you that our accuracy problem is one that we are still dealing with. In the electronic filing area, I have testified to you that we bring errors from a 20 percent on our current manual processing system down to below 3 percent with electronic filing. I would think that you would be urging me and anyone else to move quickly, but very cautiously on things.

I just accept the testimony by the people from GAO and I look forward to working with them more, and I thank you for giving me an opportunity to make another statement.

Chairman PICKLE. Well, let me then make this summation of my own, then. This committee was very disturbed last year at the survey made about taxpayer accuracy. We said then that we could not accept the fact that one-fourth of the time people called the IRS they were getting the wrong information from people who should be experts on it. Now, there is something wrong when that happens.

This year, the situation is worse, instead of better, and we have had very little, if any, substantive change in the tax laws. So we are going in the wrong direction, instead of in the correct direction. Whatever it takes, that has got to be corrected, and it is not enough to give me some round-robin answer, that it could have happened and so forth. The taxpayers cannot accept that and we cannot accept that. If it takes more personnel or some other reorganization, it has got to be done or we have got to clean out the whole bunch down the street, Mr. Murphy. We have got to get that corrected. I think you would agree with that, and it cannot get done, then we will get somebody else in there who can. It is not a simple matter.

Now, I state as a member of this committee that I have insisted that the IRS emphasize taxpayer service. You and Mr. Gibbs have done that, and I think we are much better off today than we were 2 and 3 years ago. I am proud of that factor. I am very proud of what my district is doing in trying to give service. That is the right direction. But we are going to ruin it all if we give the wrong information when they call in, and I think you would admit that.

That is why this year I thought we had better have another survey to test the accuracy. I also asked GAO to test the accuracy. GAO did not want to do it and resisted, because they just did not want to duplicate the Service's test. We made GAO do it, and we

have inconclusive figures, simply because you said different types of questions scoring was being done by each agency as against another.

I do not know how significant that 8.8 percent is, and I think we would have to analyze that, and ask how will either one of you be reporting correct and incorrect information from now on. I would expect that we must consider and study this question further.

I do not know what we will do in 1990 for the next test, since this has not been very conclusive, because of the difference in the approaches. I want that stopped. To the extent that we can add to that, I mean give you more cooperation and help, we ought to do it.

Mr. Murphy, you are just the Acting Commissioner, and we do not know who will be down there or if that person, you or anybody else, can make a request for funds and the IRS will get them, because you are just one part of the whole operation. You are not up on the top administration shelf. At some level, particularly at OMB, the administration has got to say we have to have enough money to make Internal Revenue a first-class agency. Now, if we do not give you enough funds, that is our fault. Yet, I think you have got to ask for it, although you may not be the last voice. I do not think we can just sit up here and say, well, we will give you more money, because that is not the answer in itself.

Attitude and organization go a long way, but you also may need additional funds. The Congress as a whole does not like to give Internal Revenue a lot more money, particularly in the compliance and enforcement field. You are more unpopular than Congress. Yet, we rely on you to collect over $1 trillion and we run the Government on those funds. We have got to modernize our agency and improve it the best we can, to be certain that we have staffing, and certainly equipment and material.

Now, Ms. Stathis, I am glad that you commented on the stories in the paper this morning. I do not think we can call them scare stories. The alarming headline was not made by you, but you were trying to comment on the accuracy, and the difference we have is a relatively small amount.

I think, though, whatever that difference, 40 percent or 30 percent, we will not accept that in this committee, in this Congress. The American people should not let us accept it.

Ms. STATHIS. Let me try one more time to make the record clear on these different statistics. The difference in these statistics had nothing to do with the test we made for you. The difference in the statistics only involves the test that IRS is making, and they have reported two different statistics from their own test. That is the issue.

Chairman PICKLE. All right, I accept that as an issue and that is an issue between you and IRS, and Mr. Murphy said he saw it as a misunderstanding.

Mr. MURPHY. Mr. Chairman, could I just make one quick comment?

Chairman PICKLE. All right, Mr. Murphy.

Mr. MURPHY. The whole point of that system—and again, I mentioned it this morning or earlier—and I accept what you are saying, that this committee just will not condone whatever that rate is, that it is too low, and I agree with you.

I just want to also reemphasize that that system is also dedicated to getting to the problem and getting it corrected, so we can see it working that way, and I certainly ask for your support, not only in identifying what the number is, because everybody has got a favorite number for us at this time of the year, but also what are we doing about it, and so far we have not satisfied you on that, and I intend to do everything I can to correct that.

Chairman PICKLE. Well, if you have not satisfied me, I do not think you have satisfied the American people, and that is who we both work for.

We are going to adjourn the subcommittee hearing at this point. We will have our budget hearing with the Internal Revenue Service I think in early April, and we will pursue some of these questions again, probably. So, this testimony with respect to the tax filing season service has now been completed.

I thank you very much for your testimony.

The subcommittee is adjourned.

[Whereupon, at 12:08 p.m., the hearing was adjourned.]

[GAO's responses to questions submitted by the chairman follow:]

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April 14, 1989

The Honorable Charles A. Bowsher
Comptroller General
U.S. General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. Bowsher:

I want to thank you for your assistance and testimony at the Subcommittee on Oversight's March 16, 1989, hearing on the 1989 filing season. In order to complete the record on the 1989 filing season hearing, I would appreciate your response to the following questions by the close of business April 28, 1989.

I. OVERVIEW:

The Subcommittee on Oversight requested that GAO provide an evaluation of the Internal Revenue Service operations during the 1989 tax return filing season.

1. GAO testified that three service centers, Fresno, Brookhaven and Kansas City, were processing returns at a slower pace this year. Subsequent to GAO's testimony, have these service centers returned to last year's returns processing pace? At this time, which service centers are processing returns more slowly than last year?

2. The Subcommittee asked GAO to monitor service center inventory levels throughout the filing season.

   a. At this time, how do the following inventory levels compare with prior years:

      - Adjustments and Correspondence?
      - Unpostables?
      - Error Resolution?

   b. GAO testified that the "entity" inventory was 22% higher this year than last year. What is the current status of the "entity" inventory level? At what level is this inventory unmanageable or problematic? What problems would result if this inventory reaches an unmanageable level?

3. Because of the IRS's realignment of service center workloads, some service centers will experience an increase in the number of new taxpayer accounts. Are these service centers, e.g. Cincinnati, Philadelphia, Memphis, and Kansas City, experiencing any problems with returns processing this filing season?

4. Based upon GAO's analysis of the 1989 filing season and IRS funding and staffing levels in FY 1989, what problems will result if the number of taxpayers requesting an extension of the time to file increases by 5% over the 1988 level?

5. Are the IRS's contingency plans accurate and responsive to possible problems this filing season?

6. Have all the employees been trained for the 1988 filing season? How did the training program this year compare with prior years?

7. The Subcommittee will be reviewing the clarity of tax forms and publications later this year. Is GAO seeing the same taxpayer errors as last year and are they occurring as frequently? Evaluate the effectiveness of the changes made to tax forms and publications this year.

II. TAXPAYER ASSISTANCE AT CALL-IN SITES:

1. In addition to monitoring IRS's study of telephone accuracy, GAO conducted its own independent survey of telephone accuracy at the Subcommittee's request and reported a 66% accuracy rate.

   a. Did you find the accuracy rate varied between call sites? If so, is that attributable to varied training and hiring practices?

   b. Did the difficulty of the question change the accuracy rate?

   c. Last year, GAO reported an accuracy rate of 64% during the filing season. How does the degree of technical difficulty of the questions this year compare with those used in prior GAO surveys?

2. GAO is monitoring and evaluating the current IRS test call survey. GAO indicated earlier this year, in a letter to the Subcommittee, that they have worked with IRS to develop a reliable monitoring system.

a. What are the results of GAO's monitoring of IRS's test call survey?

b. Describe GAO's monitoring.

c. GAO indicated, in a letter to the Subcommittee, that there would be two different GAO accuracy rates -- the rate determined from GAO's 22-question test and the rate that was determined from monitoring IRS's test. GAO testified regarding these survey results. What is the accuracy rate which GAO determined from monitoring IRS's test?

3. Does the accuracy rate improve for questions in areas of the law unchanged by tax reform?

4. With regard to availability of service, do the district call sites have a sufficient number of lines to handle taxpayer calls this year? On average, how many calls will a taxpayer need to place before receiving an answer?

5. GAO testified that early indications are that the training materials for telephone assistors may need to be improved. Which training materials did GAO review and how could they be improved?

III. AVAILABILITY OF TAX FORMS AND PUBLICATIONS:

1. GAO testified that there are problems with the availability of tax forms and publications in the IRS's district offices this year.

   a. Which form or publication, from the Commissioner's list of "important" forms and publications, was most frequently missing from the shelves?

   b. GAO noted the situation had worsened during the second visit to some of the district offices. I trust that GAO revisited the office which was missing 41 items on its first visit. How many of the 41 missing forms and publications remained missing at this office?

2. Some of the IRS walk-in sites visited by GAO indicated that the forms were not available because that site never intended to stock these forms or the site had not received its initial supply of the form.

a. What reasons were given for deciding a particular form would never be stocked?

b. How long must a walk-in site wait before receiving their initial supply of a document? Did GAO find that one site waiting for a delivery while the form was already available at other sites?

3. Out of the 35 walk-in sites visited, how many did not order a replenishment of forms and publications even though the supply had run out? Which forms and publications had not been reordered although the supply was exhausted?

4. GAO placed 39 random mail and phone orders to the IRS form distribution centers. Each of the orders were received within 10 days, yet only 4 of the orders arrived complete.

a. Have any of the 35 packages which arrived incomplete been supplemented with a later mailing? If so, how many would now be complete?

b. Was the package likely to arrive more complete if ordered by mail or by phone?

c. Did GAO find the reliability varied between all of the distribution centers?

d. Which forms were ordered by GAO? Are all of these forms "filing season sensitive"? Which forms were missing from the packages received? Which forms arrived subsequently?

As always, I appreciate your attention to this matter.

Sincerely,

J. J. Pickle, Chairman
Subcommittee on Oversight

JJP/sal

GAO

United States
General Accounting Office
Washington, D.C. 20548

General Government Division

May 16, 1989

The Honorable J. J. Pickle
Chairman, Subcommittee on Oversight
Committee on Ways and Means
House of Representatives

Dear Mr. Chairman:

On April 14, 1989, you asked us to respond to several questions relating to our March 16 testimony on the 1989 tax filing season. The enclosure responds to these questions.

If you or members of the Subcommittee have additional questions, you may contact me at 275-6407.

Sincerely yours,

Jennie S. Stathis

Jennie S. Stathis
Director, Tax Policy and
Administration Issues

Enclosure

FOLLOW-UP QUESTIONS TO GAO
TESTIMONY ON THE STATUS OF
THE 1989 TAX FILING SEASON

I. OVERVIEW:

1. GAO testified that three service centers, Fresno, Brookhaven, and Kansas City, were processing returns at a slower pace this year. Subsequent to GAO's testimony, have these service centers returned to last year's returns processing pace? At this time, which service centers are processing returns more slowly than last year?

GAO Response

As of April 21, 1989, IRS had received about 3 million more individual income tax returns and had processed about 200,000 more returns than it had as of April 22, 1988.

IRS gives priority processing attention to refund returns because it wants to issue refunds before the 45-day interest-free period expires. As of April 21, 1989, IRS had processed 78.4 percent of the refund returns it had received--just slightly below the 79 percent it had expected to process by then. The two service centers that had fallen the furthest behind schedule were Kansas City and Philadelphia. Those two centers had processed 76.9 and 79.3 percent, respectively, of their refund returns by April 21; they were scheduled to have processed 82.2 and 82.1 percent, respectively, by then. For Kansas City, that represents an improvement over where they stood at the time we testified. For Philadelphia, it is a slight decline. The other two centers we referred to in our testimony, Brookhaven and Fresno, had improved to the point that they were ahead of schedule in processing refund returns as of April 21.

IRS officials we spoke to on May 2, 1989, told us that they did not expect any of the service centers to have a problem getting returns processed in time. We should note that at the same time last year, two centers (Fresno and Brookhaven) were behind schedule by slightly larger amounts than Kansas City and Philadelphia were this year and yet both centers were able to process their timely-filed refund returns within the interest-free period.

2. The Subcommittee asked GAO to monitor service center inventory levels throughout the filing season.

   a. At this time, how do the following inventory levels compare with prior years: Adjustments and Correspondence, Unpostables, and Error Resolution?

b. GAO testified that the "entity" inventory was 22 percent higher this year than last year. What is the current status of the "entity" inventory? At what level is this inventory unmanageable or problematic? What problems would result if this inventory reaches an unmanageable level?

GAO Response

At April 21, 1989, IRS' adjustments/correspondence inventory stood at 542,558 according to IRS' management information system. That is 14.8 percent higher than the inventory at April 22, 1988. At the time we testified, the inventory was 2.7 percent lower than last year. We do not know what caused the significant increase since then. IRS officials suggested that the increase might have been the result of an earlier peak in correspondence activity but they will not know until next month's information is available. They explained that the adjustments/correspondence inventory took a big jump in May last year and that they would have a better basis for assessing this year's inventory level after seeing the figures for May 1989. As for the individual service centers--Andover, Cincinnati, Kansas City, Memphis, and Philadelphia all showed increases of more than 20 percent over last year with the increases ranging from 21.4 percent in Andover to 85.1 percent in Kansas City. Despite the increases, inventory levels in all 10 centers are within manageable limits according to IRS officials as corroborated by IRS' statistics. One standard for measuring manageability, for example, is that no more than 20 percent of the cases have been in inventory for 45 days or more. According to IRS' statistics, no service center had more than 10 percent of its cases in that category as of April 21.

IRS' statistics show that on a service-wide basis both the unpostables and error resolution inventories were less at April 21, 1989, than they were at April 22, 1988. The unpostables inventory was 11.3 percent lower and the error resolution inventory was 36.1 percent lower. In both cases, however, certain centers showed significant increases. In Philadelphia, for example, the unpostables inventory was up 43.6 percent while the error resolution inventory was up 26.9 percent. Those are both significant increases since we testified. IRS officials did not have specific reasons for the increases at some centers, but said that in no case was the inventory beyond manageable limits. They noted, however, that Philadelphia's inventory was close to the upper limit of manageability and that they were closely monitoring the situation. IRS considers an error resolution

inventory to be unmanageable if it begins to approach the automated Error Resolution System's capacity. That capacity, according to IRS documentation, is about 85,000 records. At April 21, each center had less than 20,000 records in its error resolution inventory.

At April 21, 1989, the entity inventory was 48.2 percent higher than it was at April 22, 1988. In discussing the large increase in this inventory, IRS officials noted, among other things, that change-of-address cases that used to be handled outside the entity function were now being handled within that function and requirements as to the point in time when a case should be included in the entity inventory were tightened. Even with the increase, according to IRS officials, the inventory at each center is manageable. Because the manageability criteria for this inventory differentiate between the different types of cases that make up the inventory and because we did not have the detailed information needed to apply the criteria, we could not independently assess manageability.

Delays in closing cases in the entity inventory would delay adjustments to such things as the taxpayer's name, address, and identification number. If that type of information is not updated, it could lead to such problems as unpostables and misaddressed notices. We have no evidence, however, that increases in the size of the entity inventory have led to delays in closing cases in that inventory.

3. Because of IRS' realignment of service center workloads, some service centers will experience an increase in the number of new taxpayer accounts. Are these service centers experiencing any problems with returns processing this filing season?

GAO Response

Three service centers--Cincinnati, Kansas City, and Philadelphia--experienced an increase in workload because of IRS' most recent workload realignment. As of April 21, 1989, those three centers had received about 3 million, 1.6 million, and 2.5 million more individual income tax returns, respectively, than they had at the same time last year. As noted in response to an earlier question, Kansas City and Philadelphia have fallen a little behind in processing their refund returns. We have no reason to believe, however, that the two centers will not be able to catch up.

4. Based upon GAO's analysis of the 1989 filing season and IRS funding and staffing levels in FY 1989, what problems will

result if the number of taxpayers requesting an extension of the time to file increases by 5 percent over the 1988 level?

GAO Response

Last year, IRS processed 5.657 million requests for extensions to file. This year, IRS plans to receive 6.161 million requests (an increase of 8.9 percent). Thus, an increase of 5 percent, as suggested in the question, should not cause any problems in and of itself assuming that the service centers are able to retain the staff needed to process the extensions. IRS has, in the past, taken steps to shield returns processing from the adverse effects of staffing cutbacks.

5. Are IRS' contingency plans accurate and responsive to possible problems this filing season?

GAO Response

We did not review IRS' contingency plans this year. We expect that they would be similar to last year's, which we found reasonable. IRS did not have to use its contingency plans last year, and we see nothing to suggest that it will have to use them this year.

6. Have all the employees been trained for the 1989 filing season? How did the training program this year compare with prior years?

GAO Response

We did not review this year's training program.

7. The Subcommittee will be reviewing the clarity of tax forms and publications later this year. Is GAO seeing the same taxpayer errors as last year and are they occurring as frequently? Evaluate the effectiveness of the changes made to tax forms and publications this year.

GAO Response

Taxpayers are making the same types of errors this year as they did last year. Because we do not have any statistics on the total number of errors being made by type of error, we cannot compare the frequency by error type. IRS does, however, compile a list of the most frequent types of errors. The list compiled as of April 19, 1989, showed that the most frequent taxpayer errors, other than math errors, involved (1) the earned income credit on Forms 1040 and

1040A, (2) the dependency status box on line 4 of Form 1040EZ, (3) the standard deduction on Form 1040A, and (4) the age/blindness indicator on Form 1040. Except for the latter, each of those areas was on IRS' list of most frequent taxpayer errors as of April 13, 1988.

We checked some of this year's forms and publications to see what changes IRS had made in an attempt to avoid the same types of errors taxpayers made last year. As we noted in our March 16 testimony, IRS added a note on this year's Form 1040EZ reminding taxpayers to check one of the boxes on line 4 and also printed the boxes in bold type to attract taxpayers' attention. Since line 4 shows up again this year as one of the areas where taxpayers made many errors, those changes would appear to have been less effective than IRS might have hoped. IRS also changed its instructions for the earned income credit and changed the Form 1040A and related instructions with respect to the standard deduction. Judging by the frequency with which taxpayers err in dealing with the earned income credit and the standard deduction, it appears that IRS' changes were not totally effective. We do not know, however, if there is anything IRS could have done differently.

II. TAXPAYER ASSISTANCE AT CALL-IN SITES:

1. In addition to monitoring IRS' study of telephone accuracy, GAO conducted its own independent survey of telephone accuracy at the Subcommittee's request and reported a 66 percent accuracy rate.

   a. Did you find the accuracy rate varied between call sites? If so, is that attributable to varied training and hiring practices?

   b. Did the difficulty of the question change the accuracy rate?

   c. Last year, GAO reported an accuracy rate of 64 percent during the filing season. How does the degree of technical difficulty of the questions this year compare with those used in prior GAO surveys?

   GAO Response

   The results of our test calls showed some variation in accuracy rates among call sites. However, these rates are not statistically comparable because the number of calls per site, although valid for a nationwide analysis, were insufficient to represent statistically valid accuracy rates

for the individual sites. Although IRS' test call system is designed to and did identify variations in accuracy rates among call sites, we are not in a position to comment on whether IRS' training and hiring practices contributed to these variations.

Regarding question difficulty, some questions in our test are more difficult than others in a relative sense and, therefore, may influence the accuracy rate. However, we would not consider any of the questions as particularly difficult. All of them are reasonable questions and ones IRS would expect its telephone assistors to answer correctly. Most of the questions require a limited amount of probing by assistors to ferret out essential facts before answering; but none of them require knowledge of complex or obscure areas of individual tax law.

The degree of difficulty of the questions used this year was about the same as in our prior surveys. Using the amount of probing required as a measure of the tests' difficulty, our tests this year and last year were comparable. This filing season's test required an average of 1.27 probes per question compared to last filing season's test which required an average of 1.25 probes per question. Furthermore, this year we were able to make a more direct comparison of the accuracy results because 11 of the 22 questions were also used in our test last year. The overall accuracy of assistors' answers to these 11 questions declined--from 72 percent last year to 64 percent this year--but the difference was primarily caused by one question on the earned income credit. Our analysis of the other comparable 10 questions shows that the accuracy of assistors' answers appears to be about the same this year as last.

2. GAO is monitoring and evaluating the current IRS test call survey. GAO indicated earlier this year, in a letter to the Subcommittee, that they have worked with IRS to develop a reliable monitoring system.

   a. What are the results of GAO's monitoring of IRS's test call survey?

   b. Describe GAO's monitoring.

   c. GAO indicated, in a letter to the Subcommittee, that there would be two different GAO accuracy rates--the rate determined from GAO's 22 question test and the rate that was determined from monitoring IRS's test.

GAO testified regarding these survey results. What is the accuracy rate which GAO determined from monitoring IRS' test?

GAO Response

Our monitoring basically involves listening to a random sample of IRS' test calls, independently scoring the responses by IRS assistors, and comparing our results with the results as scored by IRS' test callers. This sample will allow us to comment, with 95 percent confidence, on the validity of the final overall accuracy rate IRS reports. IRS' preliminary results indicate that overall the accuracy rate of its assistors during the filing season was about 62.8 percent. We are unable to provide the final results of our monitoring at this time because we have not as yet completed our analysis of the data. Our preliminary analysis does show, however, a high degree of correlation between our scoring of monitored calls and IRS' scoring on those same calls.

3. Does the accuracy rate improve for questions in areas of the law unchanged by tax reform?

GAO Response

Last year our analysis showed that questions involving areas changed by the Tax Reform Act were answered correctly 59 percent of the time compared to a 72 percent accuracy rate for questions that were not affected by these changes. We did not design this year's test such that a similar analysis could be performed. This year only 2 of our 11 questions were ones that were unchanged by the Tax Reform Act. On one question dealing with alimony, IRS assistors achieved an accuracy rate of 100 percent; 1 percent better than they achieved in our 1988 test. The other was the question dealing with the earned income credit. On that question, assistors' accuracy declined by about 60 percent. We know of no reason for this decline. For the other nine questions that were affected by tax reform, the accuracy rates remained about the same.

4. With regard to availability of service, do the district call sites have a sufficient number of lines to handle taxpayer calls this year? On average, how many calls will a taxpayer need to place before receiving an answer?

GAO Response

Overall, it appears that IRS call sites had a sufficient number of lines. For the 1989 filing season, IRS' goal was to answer 85 percent of all callers it projected would attempt to reach its call sites. In all, IRS planned to answer about 16.9 million of approximately 19.9 million callers, 1.8 million fewer calls than it answered during the 1988 filing season. To help ensure its ability to achieve this goal, given the trend that assistors are spending more time answering taxpayers' calls, IRS added 263 more telephone lines and 668 additional assistors at its call sites this filing season. However, IRS fell short of its 85 percent level of service goal when an estimated 21.2 million taxpayers called instead of the 19.9 million it had projected--a 6.5 percent increase over its projection.

In total, IRS answered 17.6 million calls, 4.1 percent more than it had planned for, but because of the 6.5 percent increase in overall estimated demand, it was only able to achieve an 82.9 percent level of service. Although this was lower than IRS hoped to achieve, placed in historical context, it was IRS' second best performance of the past decade, exceeded only by the 84.5 percent level of service it achieved last filing season.

Although no one knows how many calls, on average, taxpayers need to make before receiving an answer, IRS' survey of callers during the filing season showed that 89 percent of the callers that got through to a call site did so on their first or second call attempt. Our survey which ended March 4, 1989, showed that 69 percent of our calls were answered on our first attempt and 92 percent were answered within 5 call attempts. Our survey methodology varies from IRS' methodology in that our accessibility rates include instances where we were unable to reach call sites within 5 calls; IRS' rate is based only on those callers who were able to reach the call sites.

5. GAO testified that early indications are that the training materials for telephone assistors may need to be improved. Which training materials did GAO review and how could they be improved?

GAO Response

We have started looking at IRS' Taxpayer Service training, and our survey is still in progress. As mentioned in our testimony on March 16, 1989, before your subcommittee, we have had some preliminary indications that the student

course guide materials used to train newly hired assistors needed to be improved. Some IRS instructors told us that the course materials sent them by the National Office contained an unusual number of errors, requiring instructors to individually check the materials before planning their lessons. In two districts we were told that the materials were of limited usefulness, since the students cannot use them on the job to research answers to taxpayers' questions. Consequently, instructors use the course materials to varying degrees. As we continue our work, we will determine the significance of these early indications. We will also look at other facets of this training, including:

-- the process Taxpayer Service uses to develop its training materials,

-- the techniques used to train new assistors and how these vary among districts,

-- the methods for selecting and evaluating instructors, and

-- IRS' process for evaluating training, incorporating feedback, and revising course materials.

III. AVAILABILITY OF TAX FORMS AND PUBLICATIONS:

1. GAO testified that there are problems with the availability of tax forms and publications in IRS' district offices this year.

   a. Which form or publication, from the Commissioner's list of 'important" forms and publications, was most frequently missing from the shelves?

   b. GAO noted the situation had worsened during the second visit to some of the district offices. I trust that GAO revisited the office which was missing 41 items on its first visit. How many of the 41 missing forms and publications remained missing at this office?

GAO Response

Publication 935, dealing with Supplemental Medicare Insurance, was the item missing most often. That publication did not become available for distribution until around mid-March. We have not yet determined why availability was delayed. Other items that were unavailable in at least 14 of the 35 sites referred to in our testimony were Form 2210 (Underpayment of Estimated

Tax), Publication 929 (Tax Rules for Children and Dependents), Publication 575 (Pension and Annuity Income), and Publication 553 (Highlights of 1988 Tax Changes).

We did not say in our testimony that the situation had worsened during the second visit to some district offices. We said the situation had improved. At the one site in question, our next visit on February 16 showed that the number of missing items had decreased from 41 to 28. At later visits on March 9 and March 30, we identified 21 and 22 missing items, respectively.

Some of the IRS walk-in sites visited by GAO indicated that the forms were not available because that site never intended to stock these forms or the site had not received its initial supply of the form.

a. What reasons were given for deciding a particular form would never be stocked?

b. How long must a walk-in site wait before receiving its initial supply of a document?

c. Did GAO find one site waiting for a delivery while the form was available at other sites?

GAO Response

The primary reason we were given for not stocking a particular form was that the person responsible for deciding what to stock did not anticipate much demand for the item based on past experience and thus did not order it--even though all the forms and publications we talked about in our testimony were on a list of tax materials that each site was required to stock.

The time a site must wait before receiving its initial supply depends on the item and its availability from the printer. Some forms and publications were available before the filing season began, others were not available until February or later. As noted earlier, Publication 935 was not available until around mid-March. We are attempting to determine why some documents were not available until later in the filing season and will include that information in our report to you later this year.

Our review did not indicate a problem with one site awaiting initial delivery of an item that was already available at another site.

3. Out of the 35 walk-in sites visited, how many did not order a replenishment of forms and publications even though the supply had run out? Which forms and publications had not been reordered although the supply was exhausted?

GAO Response

At 9 of the 35 sites, the supply of at least one form or publication had run out and no replenishment had been ordered.

There were 9 different documents involved:

-- Form 4868 (Application for Automatic Extension of Time to File)

-- Instructions to Form 8283 (Non-Cash Charitable Contribution)

-- Instructions to Form 8582 (Passive Activity Loss Limitations)

-- Publication 553 (Highlights of 1988 Tax Changes)

-- Publication 575 (Pension and Annuity Income)

-- Publication 590 (Tax Information on Individual Retirement Arrangements

-- Publication 910 (Guide to Free Tax Services)

-- Publication 929 (Tax Rules for Children and Dependents)

-- Publication 1045 (Information and Order Blank for Preparers of Federal Income Tax Returns)

4. GAO placed 39 random mail and phone orders to the IRS form distribution centers. Each of the orders were received within 10 days, yet only 4 of the orders arrived complete.

   a. Have any of the 35 packages which arrived incomplete been supplemented with a later mailing? If so, how many would now be complete.

   b. Was the package likely to arrive more complete if ordered by mail or by phone?

   c. Did GAO find the reliability varied between all of the distribution centers?

d. Which forms were ordered by GAO? Are all of these forms "filing season sensitive". Which forms were missing from the packages received? Which forms arrived subsequently?

GAO Response

Some of the 35 packages that we noted in our testimony as having arrived incomplete have since been supplemented with later mailings. As of April 14, the number of complete packages among the 35 in question had risen from 4 to 9. That number is subject to change, however, as we review and purify our data.

We did not construct our test in a way that would enable us to compare IRS' performance in responding to mail orders versus phone orders. To do so, we would have had to order the exact same documents at the exact same time by both mail and phone. We did not do that. Also, we constructed our test to enable us to analyze IRS' performance overall--not to enable us to compare the performances of the three distribution centers. Even though our tests were not constructed to make such comparisons, it is possible, once our analysis is complete, that some obvious differences between mail and phone orders or between distribution centers will surface. We have not proceeded far enough in our analysis to identify any differences at this time. If there are any, we will discuss them in our final report to the Subcommittee.

Since we began our test, we have ordered hundreds of different forms and publications. We cannot provide a definitive breakdown of the num : of forms and publications that are "filing season sensitive" versus those that are not. Included in our orders, however, were a full range of documents that individuals, corporations, or other entities might need to fulfill their filing requirements. Some of the documents we ordered came from IRS' list of minor tax items which indicates that they are documents that would not be in as much demand as those on the list of major tax items, but that does not mean they are not "filing season sensitive".

There were too many different documents missing from the packages we received to list in this response. Among the major items missing from our orders were several publications dealing with issues such as miscellaneous deductions, self-employment tax, employment taxes, and supplemental medicare premiums. Several of the items that were missing from our orders at the time we testified were later received but several others are still outstanding.

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